

UNITED STATES PACIFIC COMMAND

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ASIA-PACIFIC ECONOMIC UPDATE



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FOREWORD

"America has vital strategic and economic interests that affect the lives of each and every American citizen. We must remain an Asia-Pacific power. Disengagement from Asia, a region where we have fought three wars in this century, is simply not an option. It could spark a dangerous and destabilizing arms race that would profoundly alter the strategic landscape."

*President William Clinton
Remarks to the 29th International Meeting of
the Pacific Basin Economic Council, 20 May 1996*

Today, there is nearly universal awareness of the Asia-Pacific region's demographic, economic, and political significance to global affairs. Not including the United States, the region accounts for:

- 56% of the world's population
- 33% of the gross world product
- \$600 billion foreign exchange reserves
- Oil demand of over 17 million barrels per day

In addition, eight of the world's nine largest armed forces are located in or operate in the Asia-Pacific region. But often lost in the flood of regional statistics is the profound and increasing impact the region has on U.S. interests. The Asia-Pacific region already accounts for 38% of our total two-way trade. This is greater than our total trade with Canada and Latin America, and it is more than twice our two-way trade with Europe. U.S. trade with the Asia-Pacific region accounts for over 2.5 million American jobs. As the world's economic center of gravity settles in the Asia-Pacific area, U.S. ties to the region are becoming stronger and more interdependent. Within the next decade, nearly 60% of world economic growth will be generated in East Asia. With that growth, U.S. trade and investment across the Pacific will certainly increase.

Nowhere is the confluence and interplay of economics, politics, and security as great as in the Asia-Pacific region. The U.S. is in a unique position to be an influential partner in this arena. Key to shaping the regional environment toward a favorable future is maintaining security that facilitates cooperation across all dimensions of international relations: economic, diplomatic, and military. A strong military dimension, one that is credible and has the support of the American people -- the National will -- can create room for the economic and diplomatic dimensions to work.

I am pleased to publish the 1996 edition of the USCINCPAC Asia-Pacific Economic Update as a military perspective on Asia's dynamism and its relationship to America's interests and the region's security environment.



J.W. PRUEHER
Admiral, U.S. Navy
Commander in Chief
U.S. Pacific Command

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NOTE

The information in this report delimits Asia-Pacific economies as Japan, Australia, New Zealand and, as defined by the International Monetary Fund (IMF), Asian Developing Countries. The Asian Developing Countries, which are collectively referred to as Developing Asia in the text, are listed below. The economies of Bhutan, Marshall Islands, the Federated States of Micronesia, and Palau are not listed by the IMF and are not included in this report's data on trade, aid, or investment. The U.S. Pacific Command's Area Of Responsibility (AOR) also includes North Korea and three additional islands in the Indian Ocean (Comoros, Madagascar, and Mauritius), but does not include Afghanistan or Pakistan. In January 1996 Seychelles was apportioned to the U.S. Central Command AOR, although fiscal responsibility for exercises and security assistance remained with the Pacific Command through September 1996.

IMF's Asian Developing Countries

AFGHANISTAN*	INDONESIA	BURMA	SOLOMON IS.
BANGLADESH	CAMBODIA	NAURU	SRI LANKA
BRUNEI	KIRIBATI	NEPAL	THAILAND
CHINA, P.R.	KOREA, SOUTH	NEW CALEDONIA	TONGA
FIJI	LAOS	PAKISTAN*	TUVALU
FR. POLYNESIA	MACAU	PAPUA NEW GUINEA	VANUATU
GUAM	MALAYSIA	PHILIPPINES	VIETNAM
HONG KONG	MALDIVES	SAMOA, AMERICAN	W. SAMOA
INDIA	MONGOLIA	SINGAPORE	TAIWAN

*Not in U.S. Pacific Command AOR.

**ASIA-PACIFIC
ECONOMIC UPDATE
SUMMER 1996**

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EXECUTIVE SUMMARY

"The Asia-Pacific region is currently the most economically dynamic region in the world, and on that basis alone its security would be critical to America's future."

*United States Strategy for the
East Asia-Pacific Region, February 1995*

"... there will always be a concern that today's peace and prosperity, if not carefully nurtured, could slip away. We have all welcomed the dynamic growth of the region, but this growth, stimulated by competition, can lead to new tensions."

*Winston Lord, Assistant Secretary of State for
East Asian and Pacific Affairs, Testimony to
House International Relations Committee, 30
May 1996*

INTRODUCTION

Most countries in the Asia-Pacific region subscribe to two fundamental common interests: continued peace and growing prosperity. Peace, the absence of war or armed aggression, is fundamental to individual and social well-being. However, peace does not mean the absence of conflict and tension. The region has a fundamental interest in sustaining mechanisms and diplomatic channels for resolution of conflict without resorting to armed aggression. Prosperity arises from economic development, bolstered by vigorous trade and investment. More than an end in itself, prosperity makes possible the improved quality of life, in all its political, social, cultural, and material dimensions, that is increasingly expected and demanded by people throughout the region.

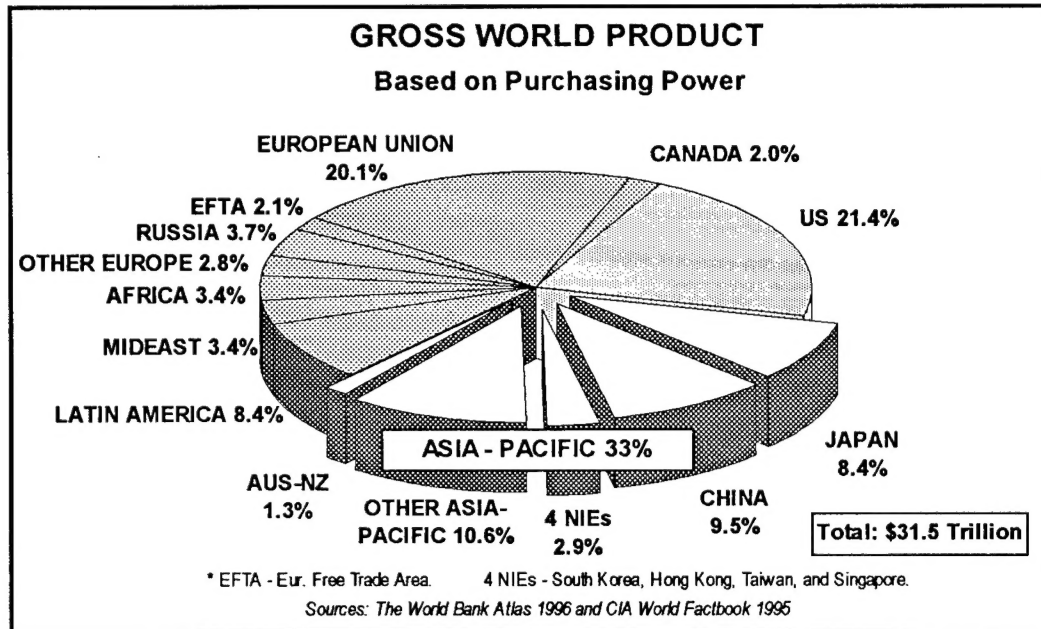
Traditionally, security is considered in the context of nation-states and their military defense. Without diminishing the continued importance of national military security, the emphasis in this report is on security at the international level, specifically, regional security. It would also be helpful to view security in the way much of Asia does as reflected frequently in seminars, workshops, and conferences: security is seen as comprehensive, with economic and political as well as military dimensions. From this view point, regional security includes protection against threats to fundamental common interests -- continued peace and growing prosperity. While this formulation of regional security may be simple, the agenda it implies is both comprehensive and compelling.

Peace and prosperity are mutually reinforcing. A peaceful environment, free of the threat of aggression or the destructive consequences of war, is a necessary precondition for the productive activity and economic development that leads to growing prosperity. And growing prosperity alleviates the frustration and despair that might otherwise ignite in the face of low and stagnant standards of living, leading possibly to armed conflict. Shared prosperity on a regional level also implies interdependence among nations which could help defuse tensions. The challenge then for Pacific Rim nations is to maintain a prime focus on productive activity and economic development throughout the region. U.S. security strategy for Asia and the Pacific supports that focus.

REGIONAL ECONOMIC GROWTH

Over the last quarter century, the Asia-Pacific region has exhibited the fastest economic growth in history. This economic growth has been attributed to two principle factors: prudent market-oriented economic policies on the part of individual countries and a secure regional environment of international order promoted by decades of U.S. engagement in Asia.

Figure 1



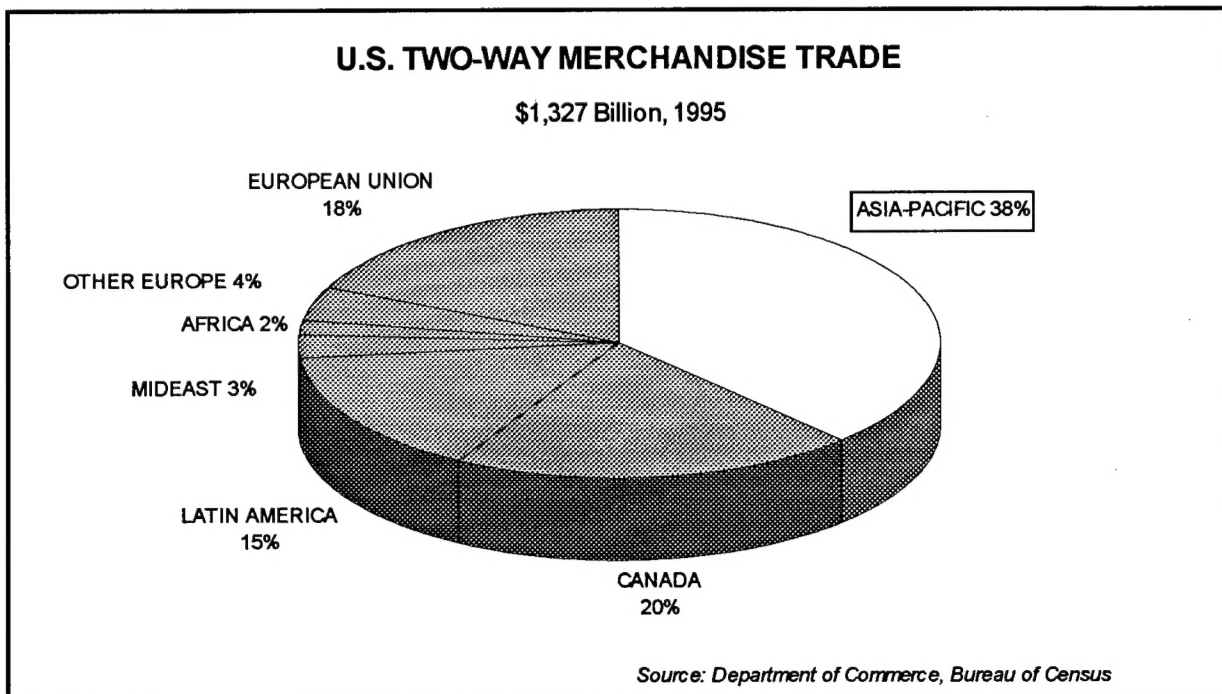
Dynamic economic growth has been widespread among Asian countries for more than three decades. Today, the Asia-Pacific region is home to the world's second and third largest economies - China and Japan. The total size of the Asia-Pacific region's output rivals, and by some measures exceeds, those of the United States and the European Union (EU). (See Figure 1.) By 1994, the Asia-Pacific region's share was 27% of world output when measured on an exchange rate basis and was 33% of world output when measured on a Purchasing Power Parity (PPP) basis.

The shift of the world's economic center of gravity towards Asia is expected to accelerate in the next ten years. The World Bank projects that from 1996 to 2005, East Asian economies will grow by 7.9% and South Asian economies will grow by 5.4%. Latin America, in comparison, will expand at a lesser rate of 3.8%. The continued growth of Asian economies and the expansion of trade between America and the Asia-Pacific region will deepen our economic interdependence, with its attendant benefits and problems. Managing interdependence will require enhanced economic cooperation and increased attention to diplomatic and military security relations in the region.

ASIAN TRADE

The U.S. economy is growing increasingly dependent on foreign trade. The share of trade in the overall U.S. economy remains small compared to other countries, but has grown significantly over the last two decades. As a share of GDP, total U.S. exports have increased from 8.4% in 1975 to 11.1% in 1995. Over the same period, U.S. imports have risen from 7.5% of GDP to 12.5%. Since the middle of the last decade, half the increase in U.S. income can be attributed to exports. Today, exports account for about one job in every eight in the United States.

Figure 2



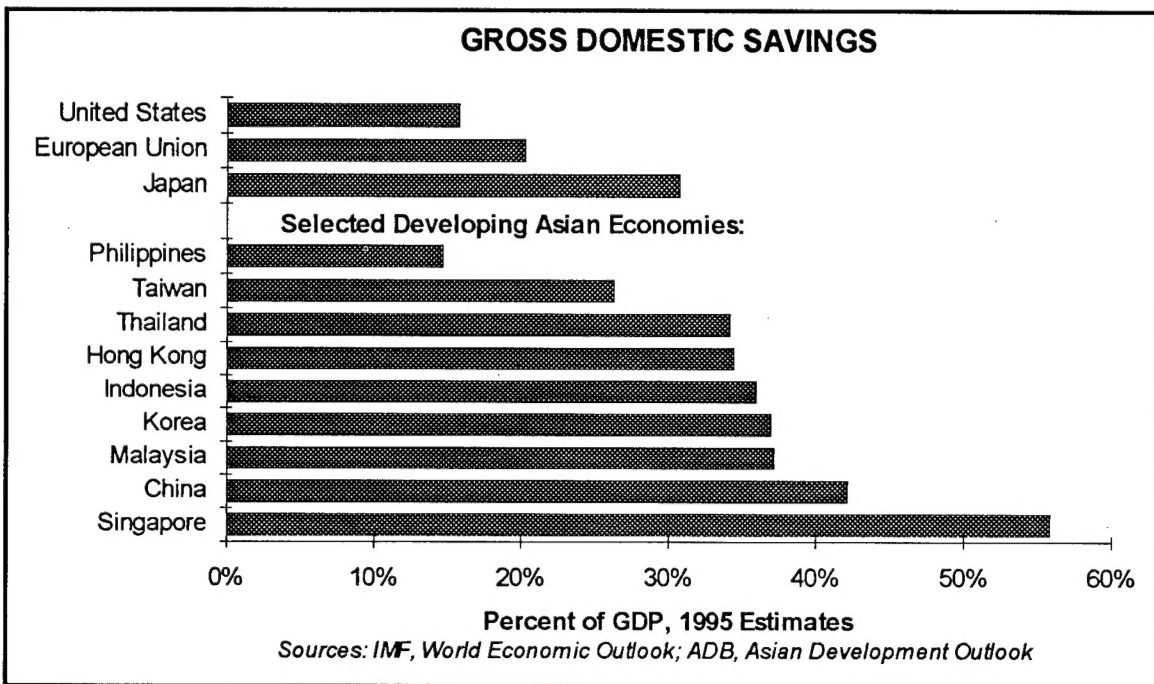
The Asia-Pacific region is America's largest and most important trading area. The Asia-Pacific region accounted for 38% of U.S. two-way goods trade in 1995. This U.S. - Asian trade showed a strong increase of 15% from \$439B in 1994 to \$503B in 1995. In 1995, U.S. trade with the European Union (EU) comprised only 18% of our total two-way goods trade and was half of U.S. trade with the Asia-Pacific region. In fact, U.S. trade with the Asia-Pacific region has exceeded trade with the EU since 1979.

The trade of Developing Asia reaches across the globe to many trading partners. About 22% of Developing Asia's exports go to the United States, 13% to Japan, 37% among its own countries, and 28% to the rest of the world. The fastest growing component of Developing Asia's trade is its intra-regional trade, with intra-regional exports growing from \$59B in 1986 to about \$295B in 1994.

ASIAN SAVINGS AND INVESTMENT

High rates of savings and investment in Asia are largely responsible for the rapid economic growth in the region. As shown in Figure 3, the savings rates of Asian countries are generally higher than those of other countries. An increasing number of Asian economies, in addition to Japan, are using excess savings and trade surpluses to invest in the region. The U.S. economy relies on Asian capital, but the United States is also a source of direct and portfolio investment in Asia. As a result, there is a strong interdependence among U.S. and Asian economies.

Figure 3



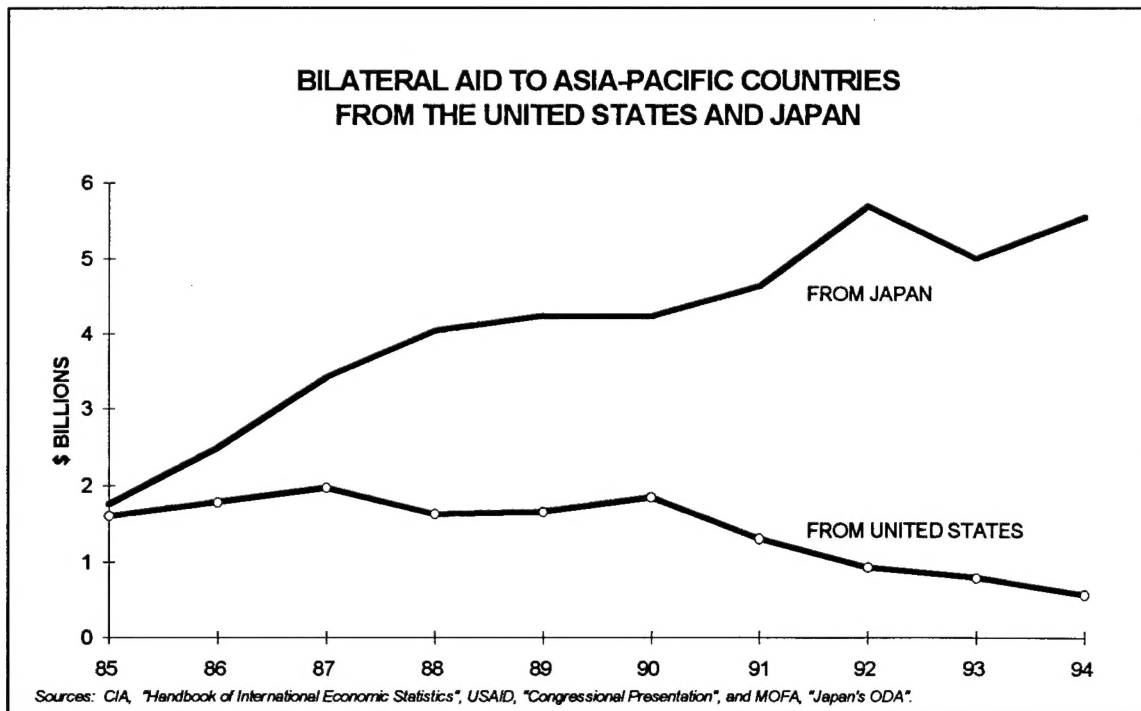
Today, Japan is the largest foreign investor in most Asian nations. A typical pattern has been Japanese investment in regional, labor-intensive industries that produce intermediate goods for export back to Japan, where the final product is manufactured for export to third countries such as the United States. However, Asian affiliates of Japanese firms increasingly sell their products to local or Japanese markets. Asian sectors that Japan has invested in include electric machinery; chemicals; metals; mining; trade and sales; services; banking, finance, and services; and real estate.

The United States has been steadily increasing its holdings in Asia over the last several decades, in both absolute terms and as a share of total U.S. direct investment. Recently, the recovery of the U.S. economy has encouraged U.S. businesses to expand further into Asia. Cumulative U.S. direct investment in the Asia-Pacific region increased from \$46B in 1987 to \$126B in 1995. The annual flow of U.S. investment to the Asia-Pacific, which during 1981 was \$2B, increased nine-fold to a flow of \$18B during 1995. While U.S. investment holdings are primarily in Europe (51% of a total \$712B), the share of U.S. investments in Asia-Pacific nations (18%) grew to exceed those in Latin America (17%) in 1995.

FOREIGN AID

Although Asian economies have shown major strides in development, Asia still accounts for half of the world's poor. Therefore, a significant demand for foreign aid in Asia still exists. In 1994, Asian nations that received assistance of over \$1.0B were China (\$3.2B), India (\$2.3B), Bangladesh (\$1.8B), Indonesia (\$1.6B), Pakistan (\$1.6B), and the Philippines (\$1.1B). Aid donors allocate funds to economic infrastructure (28% of total world-wide aid), social and administrative infrastructure (27%), sectoral production (15%), program assistance (9%), food aid (2%), and other miscellaneous programs (19%).

Figure 4



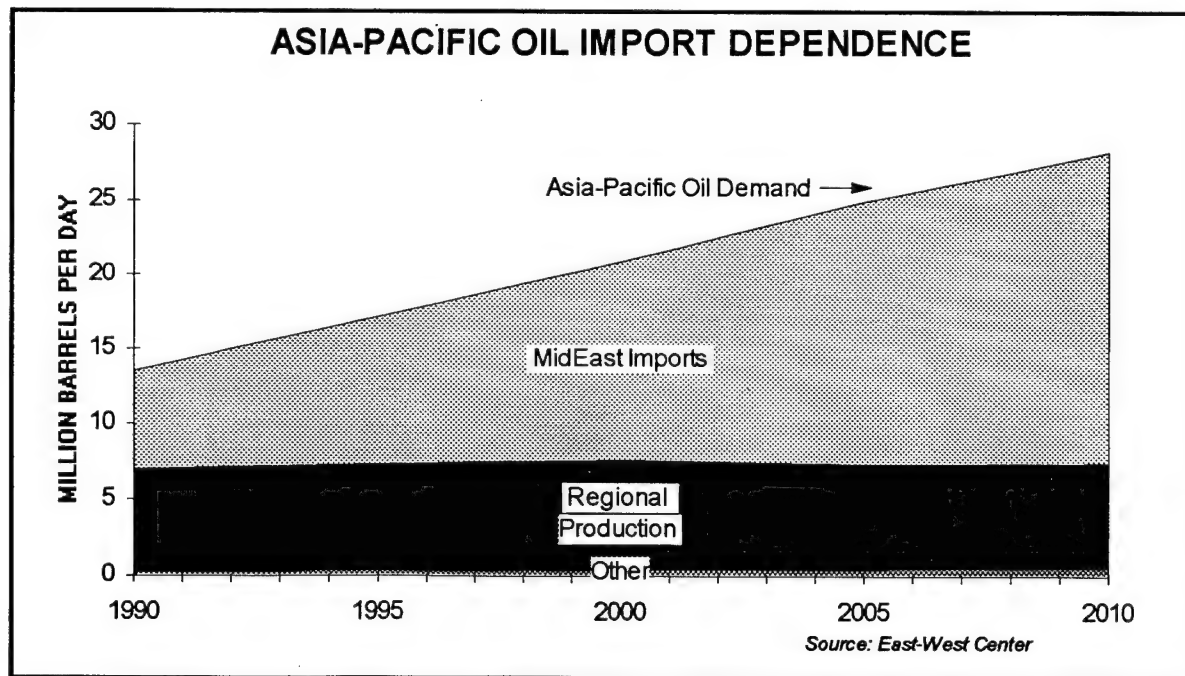
Japan is the largest donor of aid to Asia and targets most of its aid to that region. About 63% of Japan's total aid went to Asia in 1994, including contributions to multilateral aid organizations. In 1994, Japan's bilateral aid to Asia was \$5.6B. (See Figure 4) U.S. bilateral aid to Asia was \$0.6B in 1994, which was one-ninth that of Japan. In 1995, Asia received 4% of total U.S. aid obligations of \$12.7B. In contrast, the Near East and the Newly Independent States (NIS) received 53% of U.S. aid in 1995.

U.S. aid to Asia provides the technical assistance and training necessary to develop the foundations for stable, free market economies and helps create the legal, regulatory, and economic policy frameworks that enable productive foreign investment and trade. The United States now emphasizes five objectives: economic development, democracy, humanitarian assistance, and most recently, population and the environment. Stress is being placed on the role of nongovernmental organizations (NGOs).

ENERGY IN THE ASIA-PACIFIC REGION

The rapid growth of the Asia-Pacific economies has generated added pressure on the region's demand for energy. Oil is currently the dominant source of energy for the Asia-Pacific region, excluding China, which relies more heavily on coal. Oil accounted for most of the region's energy consumption (51%) in 1994, followed by coal (27%), natural gas (13%), nuclear energy (7%), and hydroelectricity (2%), when excluding China. The Asia-Pacific region's reliance on oil in energy consumption is above the world average share of 40%. In China, oil accounted for only 19% of commercial energy consumption in 1994; coal predominated, accounting for 76% of demand.

Figure 5



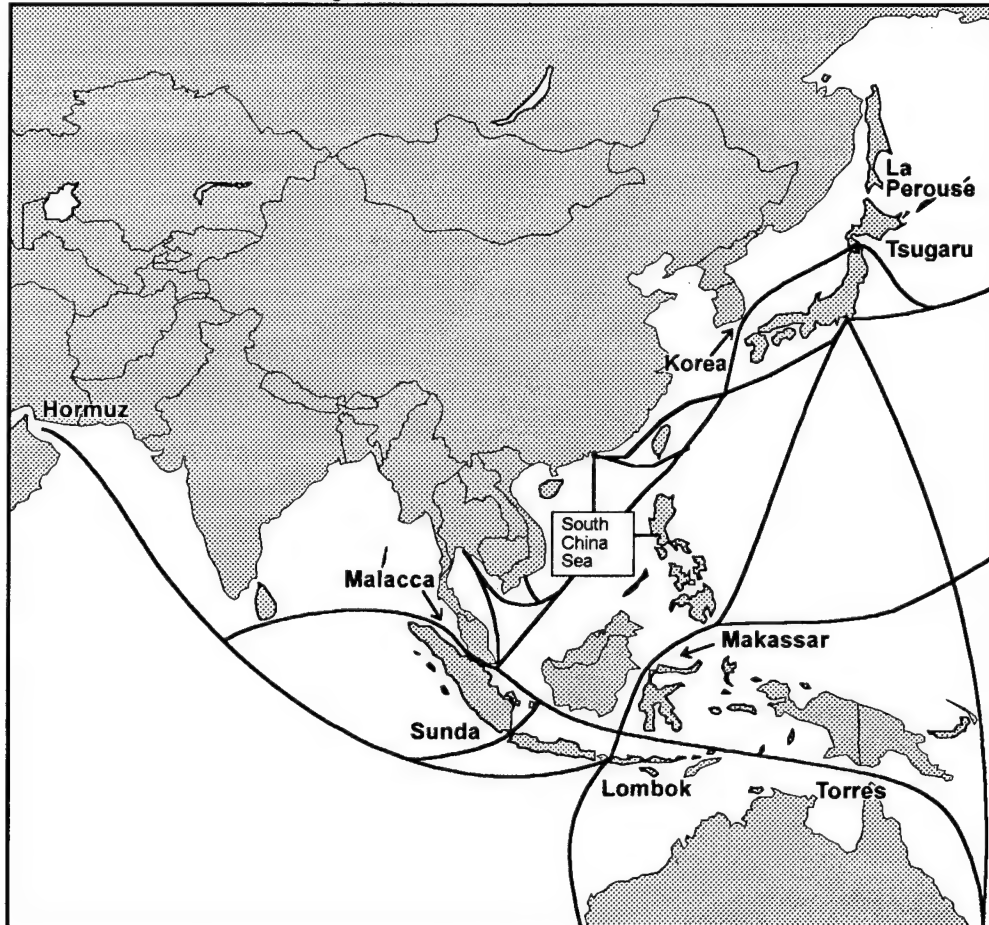
As the region enters the 21st century, oil will continue to be a critical form of energy. Oil demand in the region is now projected to rise from 17.2 MMBD in 1995 to 20.9 MMBD by the turn of the century, as shown in Figure 5. Asia-Pacific crude oil production is increasingly unable to address regional oil demand. Asia accounted for only 10% of the world's oil production of 69.6 MMBD in 1995, but about 25% of world demand. Further, the region is rapidly drawing down its supply of known reserves. Given the fast economic growth in the region, the dependence of the Asia-Pacific region on oil imports will increase. In 1995, the Middle East supplied 56% of the Asia-Pacific region's total oil consumption, and is projected to supply 63% in 2000, and 74% in 2010.

Energy demand in Asian Developing Countries is expected to grow 4.3% per year through 2015, well above the average 2.8% for developing countries. Asia's rising demand for energy presents a strong growth opportunity for American energy expertise and technology. A 10% share of the \$300B Asian market for new power generation capacity would translate into \$30B in U.S. exports, supporting an estimated 60,000 U.S. jobs over the next 7 years.

SHIPPING AND COMMERCE

The dynamism of the Asian economies is highly dependent on free passage along the shipping routes of the Asia-Pacific, especially through the shipping straits of Southeast Asia. Dramatic expansion in the volume of commerce flowing into and out of the Asia-Pacific region has sharply raised the security value of Asia's shipping lanes not only to Asian countries, but to the United States as well.

Figure 6
Major Trade Routes and Straits



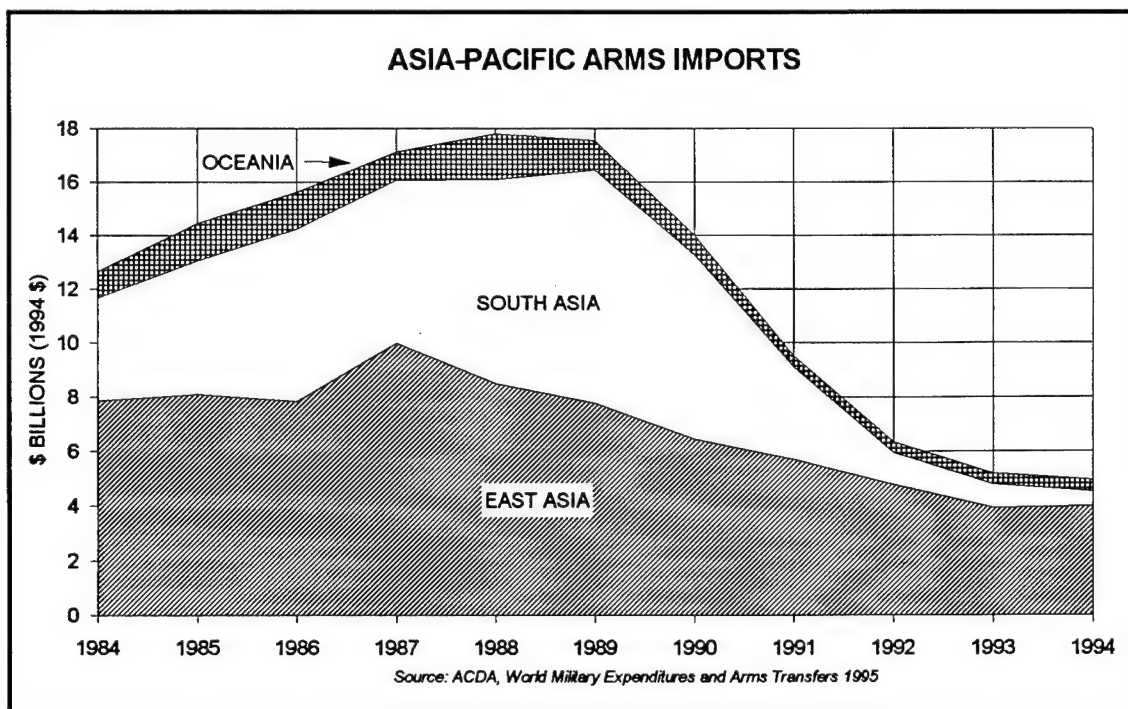
About 15% of the total value of world trade transits the Southeast Asian SLOCs. The value of exports transiting these SLOCs is high not only for Japan (\$153B in 1993), but also for Europe (\$107B); the four Newly Industrializing Economies (NIEs) of Hong Kong, Taiwan, Singapore, and South Korea (\$78B); and the United States (\$15B). The economies of Southeast Asia, Japan, and Australia are highly dependent on these straits for their trade. The SLOCs of Southeast Asia handle 54% of the total two-way trade of Southeast Asian countries, 42% of Japan's trade and 46% of Australia's trade.

The existence of unresolved claims over islands and reefs that lie alongside major shipping lanes in the South China Sea (SCS) has been a source of potential instability to the area. The United States advocates freedom of navigation, peaceful measures to resolve differences, and the use of international law, especially the 1992 United Nations Convention on the Law of the Sea.

DEFENSE SPENDING AND ARMS TRADE

Increased defense spending and military modernization by many nations have accompanied dramatic economic growth in the Asia-Pacific region. Many Asian governments have embarked on programs of arms procurement and military modernization over the last decade. However, in absolute terms, defense expenditures in the Asia-Pacific region have been stable or increasing at a moderate pace. Over the ten year period between 1984 and 1994, overall defense spending in the region grew 21% after correcting for inflation. In contrast to the rise in absolute spending, the share of military spending in Gross Domestic Product (GDP) has been declining in the Asia-Pacific region. Northeast Asia, including China, Japan, North and South Korea, and Taiwan, has the highest level of military expenditures in the Asia-Pacific. In comparison to the rest of the world, Asia-Pacific defense expenditures exceed those of the Middle East and other developing regions, and almost match spending in Western Europe.

Figure 7

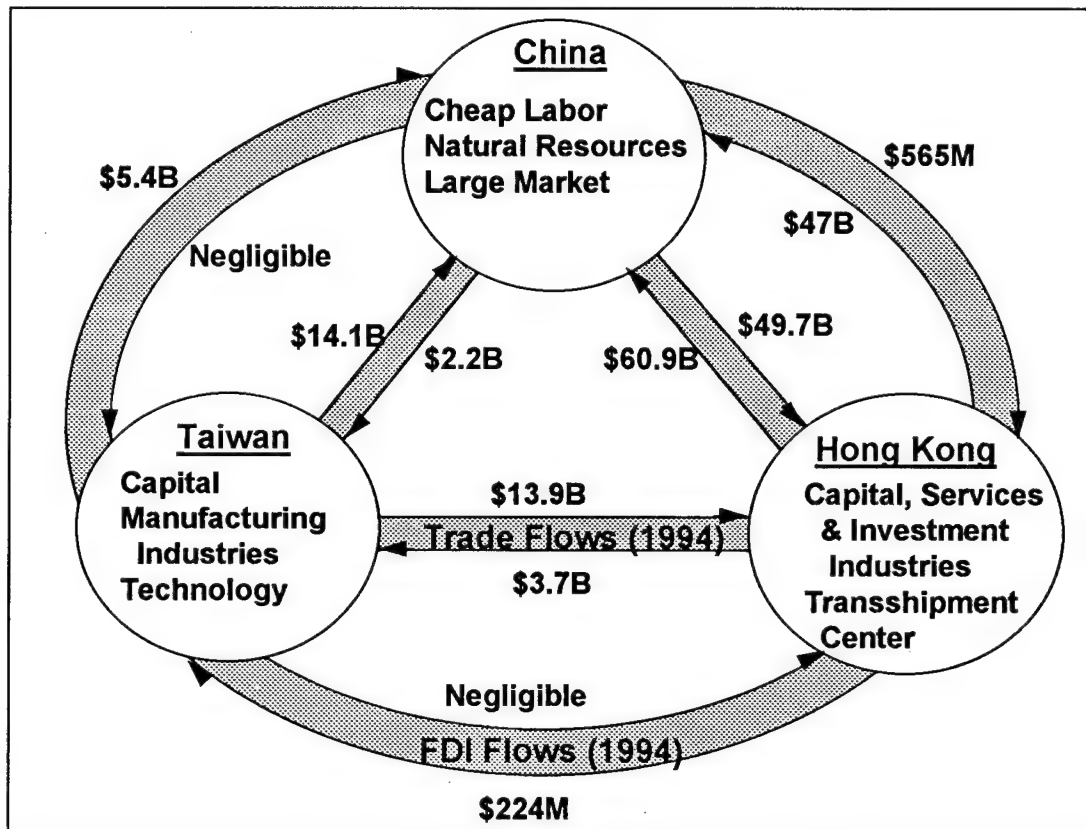


Asia's large force requirements at the turn of the decade led the region to become an important source of demand for military equipment in the declining global arms market. The Asia-Pacific region's share of world expenditure on arms imports increased from 15% in 1984 to 28% in 1989. The share subsequently declined to 18% in 1993, but climbed to 22% in 1994 due to a relatively faster decline in other parts of the world. The total value of Asian arms imports declined from a peak of \$17.5B in 1988 to \$5.0B in 1994. (See Figure 7.) The primary objectives of defense acquisitions in the Asia-Pacific region appear to be modernization of military forces, adaptation to new requirements for naval and air defense, and procurement of high-tech equipment.

THE CHINESE ECONOMIC AREA

With 1.2B people, China is the world's most populous country. It is the second largest economy in the world, measured on a purchasing power parity (PPP) basis, according to the World Bank and the CIA. This region becomes of even greater economic significance when the PRC, Hong Kong, and Taiwan, the area collectively referred to as the Chinese Economic Area (CEA), are examined as a unit. The economic activity within the CEA and the economic activity between the CEA and the world is rapidly growing, translating into increased political importance.

Figure 8



The developing consensus among economists and China analysts is that the CEA has the potential to become a major economic force in the world. Cooperation among the three economies plays an integral part in this expectation coming to fruition; Taiwan offers the financial, technological, and educational base, Hong Kong offers the financial resources, and the PRC offers a large market, cheap labor pool, and natural resources. (See Figure 8.)

To reach its potential, the CEA will have to overcome several significant hurdles. China and Taiwan will have to resume stable, peaceful relations. Hong Kong and the PRC will have to make the reversion successful. China will have to weather the transfer of power to Deng Xiaoping's successor. Finally, the CEA will have to make all of these transitions while maintaining positive relationships with the international community.

PERSPECTIVES

Over the last three decades the United States has sought to perpetuate an environment of regional security while enjoying major economic benefits from trade and investment through its engagement in Asia. But the real payoff to U.S. engagement in Asia lies in the future. For example, as Asia's economies grow, so will their requirements for development of better infrastructure: transportation, communications, energy, and environmental improvement. This needed modernizing of Asia's infrastructure presents enormous commercial opportunities for American business. And U.S. commercial presence through investment in Asia is a highly visible mode of economic engagement that complements our military engagement.

The increasing regional dependence on oil from the Persian Gulf region highlights the importance of the U.S. ability to support contingencies in the Middle East. Central to this requirement is stability and security in the Asia-Pacific region, especially Southeast Asia, which serves as a gateway to the Indian Ocean. The dramatic expansion in the volume of commerce flowing into and out of the Asia-Pacific region has sharply raised the security value of Asia's shipping lanes not only to Asian countries, but to the United States as well. Through its overseas military presence, the United States has a major role to play in protecting these sea lanes.

There is no arms race in Asia at the present time, but the People's Republic of China and several other nations are modernizing their forces. Thus, there is a continuing need for prudence in arms sales, increased transparency, expanded security dialogue, and continued American military engagement in the region to discourage any disproportionate buildup. This perspective is consistent with the *United States Security Strategy for the East Asia-Pacific Region*, the Presidential Decision Directive, *Conventional Arms Transfer*, and the *Report of the Presidential Advisory Board on Arms Proliferation Policy*.

Ideally, countries in the region share in providing regional security because it is a common good. This responsibility sharing in itself helps create trust among nations, one of the key elements of regional security. The challenge for the region is to determine cooperatively the modes and levels of responsibility sharing that are cost effective and mutually acceptable. First, this might entail enhancement by some countries of their own conventional self-defense as a contribution to the deterrence of armed aggression. Regional confidence would also be bolstered if such enhancements were accompanied by dialogue and transparency through such organizations as the ASEAN Regional Forum. Progress by individual countries in trade liberalization, according to the agenda of the Asia Pacific Economic Cooperation would be a another meaningful contribution to regional security.

The U.S. contribution to regional security has been based on its military strength, its extensive and open markets, and the mantle of leadership the international community has conferred upon it. In the economic dimension, the United States has been a champion of open trade. It has afforded generous access to its huge commercial market and has taken a strong leadership role in promoting regional and global trade arrangements: the Asia-Pacific Economic Cooperation forum and the World Trade Organization. In the military dimension, the U.S. Pacific Command's Strategy of Cooperative Engagement, with its emphasis on overseas presence, strong alliances and friendships, and crisis response capability, directly supports the strengthening of regional security, the precondition for peace and prosperity.

SECTION I

INTRODUCTION

"Working together, our nations can rise to the challenges of this time, reinforcing our strength and prosperity into the 21st century. We can build an Asia-Pacific region where fair and vigorous economic competition is a source of opportunity, where nations work as partners to protect our common security, where emerging economic freedoms are bolstered by greater political freedoms, where human rights are protected and diversity is respected."

*President William Clinton
Remarks to the 29th International Meeting of
the Pacific Basin Economic Council, 20 May 1996*

"Preventive defense may be thought of as analogous to preventive medicine. Preventive medicine creates the conditions which support health, making disease less likely and surgery unnecessary. Preventive defense creates the conditions which support peace, making war less likely and deterrence unnecessary."

*Defense Secretary William Perry
Speech at John F. Kennedy School, Harvard
13 May 1996*

CHAPTER 1

REGIONAL SECURITY FOR CONTINUED PEACE AND GROWING PROSPERITY

The economic dynamism of the Asia-Pacific region has been the subject of much academic research and journalistic commentary. Along with the end of the cold war, the tremendous success of economic development in East Asia has stimulated new thinking about the meaning of security. This thinking has been accompanied by questions regarding the relationship between economics and security in international relations. For example, (1) Should economics or military security be the primary regional concern and the basis for foreign policy? (2) Are international economic relations primarily cooperative or competitive and what are the security implications?

As a conceptual foundation for the overall report, this introductory chapter offers a perspective on these issues that links economic ideas to a broader interpretation of security. Taking a broader view permits strategic thinking and security cooperation to go beyond the either/or nature of the questions posed above. Debates about the primacy of economics or military security tend to be non-productive. Multinational dialogue within such organizations as the ASEAN Regional Forum (ARF), the Council of Security Cooperation in the Asia-Pacific (CSCAP), the Asia-Pacific Economic Cooperation (APEC) organization, and the Pacific Basin Economic Council (PBEC) make it abundantly clear that both economics and military security are high priority concerns throughout the region. Moreover, they are linked. It is also clear that regional leaders interpret security more comprehensively than just military defense; security has political, economic, and environmental dimensions as well.

Discussions about the second question are often distorted by a fixation on the vague concept of international competitiveness and the use of military metaphors to describe international economic relations. With this vocabulary, international trade and investment are readily characterized as win-lose propositions, and in the extreme, as form of warfare. A more constructive view recognizes that economic activity involves both competition and cooperation: competition among sellers and competition among buyers shape global markets for goods and services; yet economic exchange between individual buyers and sellers or trade between nations is inherently cooperative, providing an opportunity for mutual gain.

Competition and cooperation are the yin and yang of the global economic system. The Annual Report of the Council of Economic Advisors (1996) describes the positive-sum nature of the open trading system in the following way:

"Open, competitive trade promotes the economic welfare of all countries that engage in it, and does so in four ways. It secures the benefits of national comparative advantage, allowing each trading economy to devote more of its resources to producing those goods and services that it can produce most efficiently. It sharpens domestic competitive pressures, spurring productivity gains. It quickens the flow of technology and ideas, allowing countries to learn from each other. And it broadens the variety of inputs available to producers and final goods available to consumers, boosting efficiency and standards of living."¹

¹ *Economic Report of the President together with the Annual Report of the Council of Economic Advisors*, February 1996.

Rather than applying military metaphors and warfighting vocabulary to describe international economic relations, the perspective advocated here uses economic ideas to enrich understanding of regional security and its attributes. Our main points are these:

- Regional leaders express a fundamental interest in continued peace and growing prosperity.
- Achieving continued peace and prosperity represents a major challenge to Pacific Rim nations: maintaining a regional focus on productive activity and economic development.
- Regional security can be viewed as protection against threats to fundamental common interests. It is a region-wide, common good that creates space and time for development to occur.
- The link between security and development is cooperation.
- Ideally, countries in the region share in providing regional security, because it is a common good.
- American citizens benefit from the U.S. contribution to regional security.

Common Interests in the Asia-Pacific Region

Multinational security conferences and seminars indicate that most countries in the Asia-Pacific region subscribe to two fundamental common interests: continued peace and growing prosperity. Peace, the absence of war or armed aggression, is fundamental to individual and social well-being. However, peace does not mean the absence of conflict, that is, domestic or international political tension arising from opposing interests and objectives. Conflict is an inevitable correlate of progress and economic development. The region has a fundamental interest in sustaining mechanisms and diplomatic channels for resolution of conflict without resorting to armed aggression.

Prosperity arises from economic development, bolstered by vigorous trade and investment. More than an end in itself, prosperity makes possible the improved quality of life, in all its political, social, cultural, and material dimensions, that is increasingly expected and demanded by people throughout the region. Given these expectations, leaders in the region realize that legitimacy of governments depends directly on continued economic progress.

Peace and prosperity are mutually reinforcing. A peaceful environment, free of the threat of aggression or the destructive consequences of war, is a necessary precondition for the productive activity and economic development that leads to growing prosperity. And growing prosperity alleviates the frustration and despair that might otherwise ignite in the face of low and stagnant standards of living, leading possibly to armed conflict. The challenge then for Pacific Rim nations is to maintain a prime focus on productive activity and development, both economic and political, throughout the region. U.S. security strategy for Asia and the Pacific supports that focus.

Regional Security as a Common Good

Traditionally, security is considered in the context of nation-states and their military defense. Without diminishing the continued importance of national military security, the emphasis in this report is on security at the international level, specifically, regional security. It would also be helpful to view security as comprehensive, in the way much of Asia does. From this perspective, regional security includes protection against threats to fundamental common interests -- continued peace and growing prosperity. While this formulation of regional security may be simple, the agenda it implies is both comprehensive and compelling. Potential threats to peace and prosperity in the Asia-Pacific region are generic and transnational, for example: proliferation of weapons of mass destruction; arms races or disproportional military buildups; terrorism; natural disaster; severe environmental degradation; protectionism and predatory trade practices; and national, religious or ethnic extremism.

In addition to being international and comprehensive, regional security has the special property of being a so-called public good, or collective good. Regional security creates the space and time that allows productive activity and economic development to occur. Therefore, all Asia-Pacific nations benefit from regional security to some degree, regardless of how much they contribute toward providing it. This characteristic of security is the source of the free-rider problem, the alleged basis for complaints by those Americans who favor disengagement from Asia; the United States bears the burden of security in Asia, and Asian countries are not contributing their fair share. This argument weakens considerably when security is taken to be comprehensive. For it reveals channels through which Asian nations are already making meaningful contributions to regional security, and it opens the way for these countries to do more, at acceptable economic, political, and diplomatic cost.

Building on this framework, the elements of regional security would include the following political, military, and economic aspects.

- Political/Diplomatic Dimension:
 - A complex web of bilateral relations in the region
 - Organizations to support multilateral dialogue (ARF, CSCAP)
 - International order with standards of behavior for the community of nations and mechanisms for diplomatic solutions to regional problems
 - An environment of regional trust and confidence among nations which is fundamental to international cooperation
 - The absence of a hegemonic power with the capability and intent to dominate the region
- Military Dimension
 - Viable international agreements and protocols to contain proliferation

- Credible nuclear and conventional deterrence of armed aggression
- Freedom of navigation and protection of vital shipping lanes in the region
- Transparency on military capabilities and intentions
- Economic Dimension
 - Maintenance of the open trading system regionally and globally
 - Arrangements and organizations for promoting multinational economic cooperation - e.g., APEC
 - Principles, incentives, and institutions to promote sustainable development, including prudent management of energy, resources, and the environment; and capability to provide humanitarian assistance, and disaster relief.

Link Between Security and Development: Cooperation

Promoting cooperation throughout the Asia-Pacific region lies at the heart of the Pacific Command Cooperative Engagement Strategy. Cooperation serves as the critical two-way link between regional security and economic development. Three points are relevant.

First, security is the foundation of trust and confidence in the region, the precondition for meaningful cooperation. The perception of mutual security reduces incentives for strategic behavior and makes productive activity more attractive than expropriation. In addition, regional security helps temper fears of deepening interdependence.

Second, cooperation is essential to economic development. Regional security creates the space and opportunity for development, but more is needed to bring development about. Cooperation provides the basis for voluntary exchange, the motivating force behind the creation of markets and the basis of international trade and investment. Cooperation sustains the multinational organizations and arrangements that promote growth through development financing, technical assistance, and coordination of economic policies: the World Trade Organization, the Asia-Pacific Economic Cooperation, the World Bank, the Asian Development Bank, and the International Monetary Fund. And finally, economic development provides nations with the resources to participate more fully in the cooperative provision of regional security.

Multinational Provision of Regional Security

Ideally, countries in the region share in providing regional security because it is a common good. This responsibility sharing in itself helps create trust among nations, one of the key elements of regional security. As with other goods, the production of regional security has costs -- in this case, diplomatic and political, as well as economic costs. The challenge for the region is to cooperatively determine modes and levels of responsibility sharing that are cost effective and mutually acceptable. First, this might entail enhancement by some countries of their own conventional self-defense as a contribution to the deterrence of armed aggression. Regional

confidence would also be bolstered if such enhancements were accompanied by dialogue and transparency through such organizations as the ASEAN Regional Forum. Progress by individual countries in trade liberalization, according to the agenda of the Asia Pacific Economic Cooperation would be a another meaningful contribution to regional security.

The U.S. contribution to regional security has been based on its military strength, its extensive and open markets, and the mantle of leadership the international community has conferred upon it. In the economic dimension, the United States has been a champion of open trade. It has afforded generous access to its huge commercial market and has taken a strong leadership role in promoting regional and global trade arrangements: the Asia-Pacific Economic Cooperation forum and the World Trade Organization.

Through its overseas military presence, adherence to its treaty commitments, and active engagement with friends and allies throughout the Asia-Pacific region, the United States contributes to a security environment conducive to peace and prosperity:

- Through the reassurance it provides, it serves to stabilize defense spending in the region, allowing developing countries to allocate resources to more productive uses that promote economic development.
- It serves to deter armed conflict in the region, thus avoiding a military involvement that would cost lives and inflate future defense budgets.
- By protecting freedom of navigation, it secures the sea lanes and provides access to the Middle East and Arabian Gulf oil.
- By enhancing interoperability of forces, it facilitates the formation of multinational coalitions to counter aggression or conduct humanitarian operations, reducing the security burden on the United States.

Benefit to American Citizens

"What's in it for America? What's the return on U.S. investment in regional security?" These questions increasingly challenge policy makers and military leaders who must articulate a rationale for continued U.S. engagement in Asia. The answers seem straight forward when the questions are set in the context of regional security as a comprehensive and international common good. As a Pacific Rim nation, the United States shares a fundamental interest with other nations in regional peace and prosperity. U.S. investment in regional security supports the maintenance of a regional focus on productive activity and economic development. This focus pay dividends in several respects.

First and foremost, such a focus reduces the incentive for nations in the region to amass destructive military power that might in the future be hostile to the United States or its allies. Secondly, promoting economic development is perhaps the most effective way for the United States to achieve its objective of expanding freedom, democracy, and respect for human rights throughout Asia. Political freedom tends to follow economic freedom; with economic

development comes a rising middle class with heightened expectations, aspirations, and access to information - a major weapon in the fight against injustice.

As documented throughout this Economic Update, current economic benefits and potential future benefits are enormous. Near-term gains from trade, both imports and exports, enhance America's economic welfare overall by increasing national income. Unfortunately, growth and economic change can create some social dislocation. The challenge for U.S. policy makers is to ease the social burden of economic change without resorting to protection, which could be perceived by other Pacific Rim countries as a direct threat to regional security.

In the longer term, trade and investment stimulate growth through several channels: the international division of labor that accompanies trade generates productivity gains that boost national output; U.S. investment in Asia generates profits and promotes the development of export markets; in turn, foreign investment in the United States contributes to the build-up of physical and human capital, which is the foundation of future growth; and both trade and investment increase the flow of technology and ideas, the twin engines of progress.

Finally, to close the loop, growth promotes America's future security. Economic growth in the United States builds the national capability and confidence to remain engaged. Cooperative engagement in Asia and the Pacific, now and in the foreseeable future, is the best U.S. strategy to promote continued peace and growing prosperity, both central to the well-being of American citizens.

SECTION II

ECONOMIC DYNAMICS OF THE ASIA-PACIFIC REGION

"We have an opportunity to create a new system of international relations, a system founded not on mutual fear -- but on mutual prospects; a system animated not by the threat of mutual destruction -- but by the potential for mutual prosperity. International trade is at the heart of this new system."

*U.S. Trade Representative Charlene Barshevsy
Remarks to the 29th International Meeting of
the Pacific Basin Economic Council, 20 May 1996*

"Asia's prosperous stability is vital to America's economic health and the world's security."

*United States Security Strategy for the East
Asia-Pacific Region, February 1995*

CHAPTER 2

REGIONAL ECONOMIC GROWTH

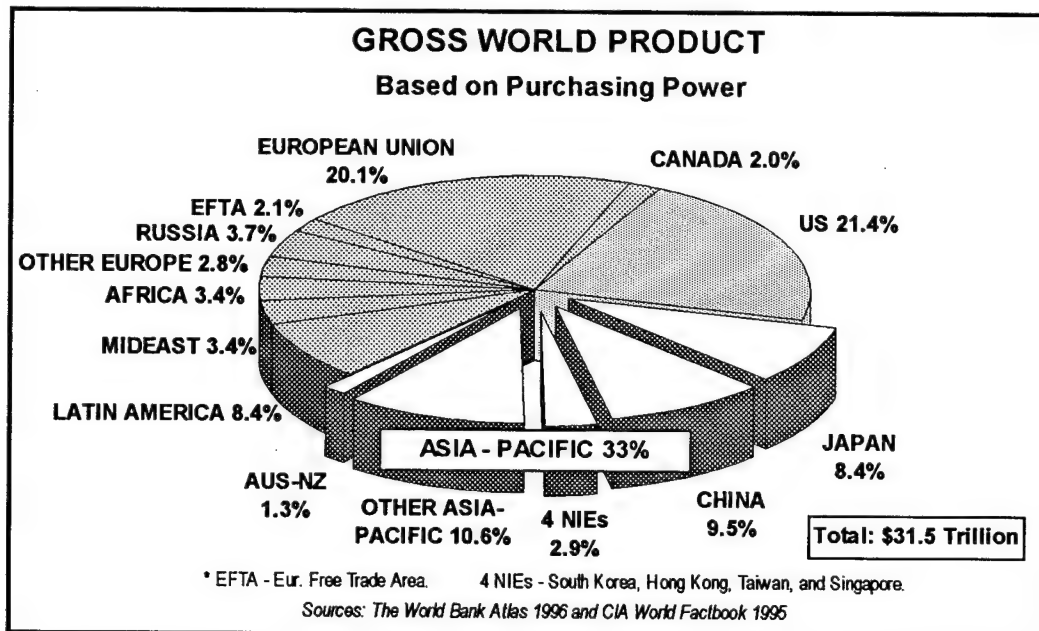
Over the last quarter century, the Asia-Pacific region has exhibited the fastest economic growth in history. This economic growth has been attributed to two principle factors: prudent market-oriented economic policies on the part of individual countries and a secure regional environment of international order promoted by decades of U.S. engagement in Asia. This chapter describes the dynamic growth of Asian economies and outlines the basis for America's enormous economic stake in the region.

Asian Dynamism

Dynamic economic growth has been widespread among Asian countries for more than three decades. Today, the Asia-Pacific region is home to the world's second and third largest economies - China and Japan. The total size of the Asia-Pacific region's output rivals, and by some measures exceeds, those of the United States and the European Union (EU). (See Figure 2-A.)

- In 1960, Asia accounted for just 4% of the world's economic output. By 1994, the Asia-Pacific region's share was 27% of world output when measured on an exchange rate basis and was 33% of world output when measured on a Purchasing Power Parity (PPP) basis.¹
- Asia-Pacific output already far exceeds U.S. and EU totals, when measured on the basis of Purchasing Power Parity (PPP). (See Figure 2-B.)

Figure 2-A



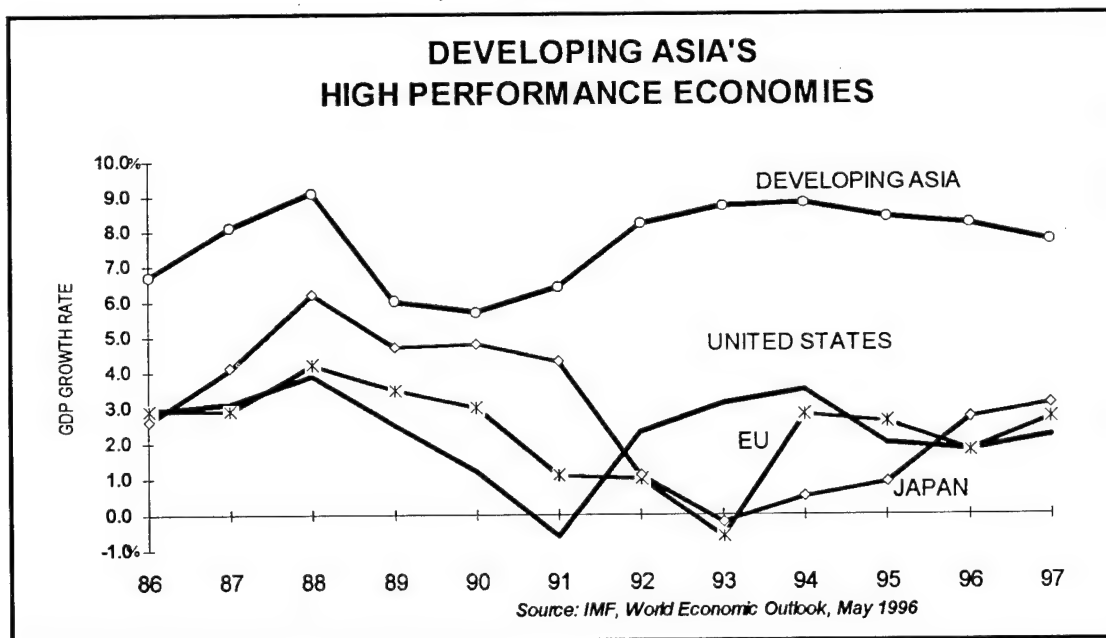
¹ World Bank, *World Bank Atlas 1996*. The exchange rate method converts foreign currency to U.S. dollars using market exchange rates, and is fairly straightforward to calculate; however, it does not account for the buying power of a country's currency for those goods and services that are not transacted in the international trading system, but only trade in domestic markets. The PPP method is more cumbersome to estimate, but does account for a country's domestic purchasing power.

Figure 2-B
Comparison of Regional Output (1994)

	PPP Basis	Exchange-Rate Basis
Asia-Pacific	\$10.3T (33%)	\$7.0T (27%)
United States	\$6.7T (21%)	\$6.7T (26%)
EU	\$6.3T (20%)	\$7.1T (27%)
World	\$31.5T	\$26.1T

In general, Developing Asia (which consists of Asia-Pacific countries less the industrialized countries of Japan, Australia, and New Zealand) has had higher and more sustained economic growth than the United States, Japan, and the EU over the last decade.² (See Figure 2-C.) Developing Asia contains the world's best performing economies, as well as some of the world's problem economies.

Figure 2-C



- China, which has averaged 9.9% annual growth over the last ten years, is the world's fastest growing economy, and is now ranked as the world's second largest economy on a PPP basis.³
- Japan experienced declining growth rates since 1988 and is slowly recovering from a recession in 1993.
- The Four Newly Industrializing Economies (NIEs) of South Korea, Taiwan, Hong Kong, and Singapore averaged growth of 8.3% over the last ten years.⁴

² International Monetary Fund (IMF), *World Economic Outlook*, May 1996; IMF, *Press Release*, April 17, 1996 (www.imf.org/).

³ World Bank, *World Bank Atlas 1996*, and CIA, *World Factbook 1995*.

- The countries of Southeast Asia are following the example of the NIEs and have experienced an average annual growth rate of 7.3% over the last ten years. South Asia, poorer and more populous, has been progressing with a modest, but respectable, average growth rate of 5.4% over the same period.⁵
- Despite Asia's overall dynamism, backward economies exist in Asia. Economies such as North Korea and Burma are endowed with natural resources, but are not performing well.
- Poverty is prevalent in many areas of the region. Bangladesh, Cambodia, and Laos are among the poorest countries in the world, with per capita incomes of less than \$320.

Many studies have examined Asia's dynamism in an attempt to determine the common elements of economic success.⁶ Rather than a single economic recipe, these studies reveal a diversity of country experiences and policy approaches to economic development. Some elements of broad applicability seem to stand out:

- Vigorous trade with the United States, Japan, and Europe and expanding regional demand for goods and services.
- High rates of national saving and aggressive investment in physical and human capital.
- Stabilizing macroeconomic policies conducive to investment and commercial activity.
- Pro-market government interventions intended to promote cooperative investment, and the steering of resources into productive activities.
- Reliance on cultural factors that value education and a strong work ethic.

The shift of the world's economic center of gravity towards Asia is expected to accelerate in the next ten years. The World Bank projects that from 1996 to 2005, East Asian economies will grow by 7.9% and South Asian economies will grow by 5.4%. Latin America, in comparison, will expand at a lesser rate of 3.8%.⁷ But as both East and South Asia achieve continued growth, internal stresses will become more apparent. The World Bank notes that

"... countries in the region will continue to face tough challenges if they are to sustain the rapid pace of growth and integration of recent years. These include dealing with infrastructure bottlenecks, fiscal deficits, military expenditures, and inefficient public sectors, as well as

⁴ ADB, *Asian Development Outlook 1996 and 1997*, April 1996, and ADB, *Press Release April 11, 1996*, (www.asiadevbank.org/netscape.2/data/NR038-96.html).

⁵ ADB, *ibid*.

⁶ See for example, Petri, Peter, *Lessons of East Asia: A Country Studies Approach*, Study done for Asian Miracle Project; The World Bank Report, *The East Asian Miracle: Economic Growth and Public Policy*, Oxford University Press 1993; and Roumasset, James and S. Barr, (eds.) *The Economics of Cooperation: East Asian Development and the Case for Pro-Market Intervention*, Westview Press, 1992.

⁷ World Bank, *Global Economic Prospects and the Developing Countries 1996*, Table 1, April 1996 (www.worldbank.org/html/extb/GepEnglish.html).

lowering high trade and investment barriers and extending the scope of competition in domestic factor and product markets."⁸

An overview of Asian economies presented to the 1996 Asia-Pacific Senior Seminar in Honolulu, Hawaii, gave the following perspective:⁹

- Economic growth in Asia will slow, but Asia will still grow faster than the rest of the world over the coming decade.
- There is little evidence of a discriminatory trade bloc inimical to U.S. interests developing in Asia. In financial terms, there is little evidence of an emerging yen bloc, despite Japan's financial muscle. On the contrary, if there is a currency bloc in Asia, it is a dollar, not yen, bloc. Official impetus for an expanded use of the yen has come from Washington, not Tokyo.
- U.S. trade will be increasingly oriented towards NAFTA and the Asian countries, i.e. the APEC countries. At the same time, the U.S. share of Asian trade will fall as intra-Asian trade continues to grow rapidly.
- As Asia's trade and financial dependence on the United States declines, U.S. unilateral approaches in economic affairs are likely to be increasingly ineffective. And at the same time, the United States is going to need cooperation from its trade partners to achieve its goals. That suggests that the United States will need to move increasingly toward multilateral solutions. Organizations such as the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation (APEC) network will grow in importance to the United States.

The U.S. Economic Stake in the Asia-Pacific Region

The economic relationship between the United States and countries of the Asia-Pacific region has become vital to America's security and economic well-being. America benefits not only from international order and stability, but also from increased trade and investment.

- U.S. merchandise trade with the Asia-Pacific region totaled \$501B in 1995, making the Asia-Pacific region America's most robust trading area. A full 42% of U.S. merchandise imports comes from the Asia-Pacific region, and 33% of U.S. merchandise exports is sold to the Asia-Pacific. As Asia's economies grow, so do their requirements for development of better infrastructure: transportation, communications, energy, and environmental improvement. This needed modernizing of Asia's infrastructure presents enormous commercial opportunities for American business.
- U.S. exporters have found that direct investment in Asia facilitates their export sales. American companies have yet to realize the full potential of investing in Asia; only 18% of total U.S. overseas holdings in 1995 was in the Asia-Pacific region. Nevertheless,

⁸ World Bank, *Global Economic Prospects and the Developing Countries 1996*, April 1996, p. 18.

⁹ Noland, Marcus, "Economic Trends and Issues," *1996 Asia-Pacific Senior Seminar Report*, The Asia-Pacific Center, The East-West Center, and Pacific Forum, Honolulu, April 1996; and *Implications of Asian Economic Growth*, Number 94-5, Institute for International Economics, 1994.

cumulative U.S. direct investment in the Asia-Pacific region has increased substantially, from \$46B in 1987 to \$126B in 1995.¹⁰

- Asia is rapidly becoming a world-class source of capital for investment and exchange. Countries of the Asia-Pacific region held \$125B, or 22% of a total of \$560B in foreign direct investment holdings in the United States in 1995.¹¹ Also, Asia-Pacific economies had an accumulation of over \$600B of foreign exchange reserves in 1995.¹²

The continued growth of Asian economies and the expansion of trade between America and the Asia-Pacific region will deepen our economic interdependence, with its attendant benefits and problems. Managing interdependence will require enhanced economic cooperation and increased attention to diplomatic and military security relations in the region.

¹⁰ Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

¹¹ Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

¹² *Far Eastern Economic Review*, April 25, 1996 and March 9, 1995; IMF, *World Economic Outlook*, Table A36, May 1996.

CHAPTER 3

ASIAN TRADE

Economic relations in the Pacific basin may be characterized first and foremost by the vigorous trade that occurs throughout the region. This chapter describes key trends and issues of U.S. trade with Asia as well as Asia's regional and global trade. In addition to opportunities for U.S. exports to Asia's dynamic economies, there are also significant gains from trade to be realized through the import of Asian goods and services.

Trade and the U.S. Economy

The U.S. economy is growing increasingly dependent on foreign trade. The *Economic Report of the President* for 1996 states that,

"America has long led the world in championing open trade and competition. The result has been an unprecedented period of worldwide growth in incomes and trade. The expansion of international trade that supported postwar growth in incomes has been accompanied by dramatic transformations in the economies of the United States and other countries. In 1960, trade—exports plus imports—was equivalent to just 9 percent of U.S. gross domestic product (GDP); that figure is now 23 percent.¹ Twelve million American workers now owe their jobs to exports, and the opportunities for global sales represents a critical part of firms' investment, research and development, and hiring decisions. The importance of exports to the U.S. economy has been strikingly apparent in the last 3 years; U.S. exports of goods and services have grown by 20 percent, accounting for about one-third of real GDP growth.²

The share of trade in the overall U.S. economy remains small compared to other countries, but has grown significantly over the last two decades. As a share of GDP, total U.S. exports have increased from 8.4% in 1975 to 11.1% in 1995.³ Over the same period, U.S. imports have risen from 7.5% of GDP to 12.5%. (See Figure 3-A.) Since the middle of the last decade, half the increase in U.S. income can be attributed to exports.⁴ Today, exports account for about one job in every eight in the United States.⁵

- America's export sector may not have grown to its full potential. Germany, France, and Canada export between 18 and 25% of their GDP, whereas, the United States exports around 11.1%. Only 10 percent of U.S. firms are regular exporters; some 50 firms account for nearly half of U.S. exports.
- U.S. exports are expected to grow 8.5-10% annually through the year 2000, in contrast to a 7% average for the last five years. By 1998, U.S. exports may total \$1 trillion a year.⁶

¹ Final figures for 1995 place the figure at 24%. (Department of Commerce, *Survey of Current Business*, April 1996.)

² Office of the President, *Economic Report of the President together with the Annual Report of the Council of Economic Advisors*, February 1996, (www.access.gpo.gov/eop/).

³ Department of Commerce, *Survey of Current Business*, "Table 1 - Gross Domestic Product," January-February 1996.

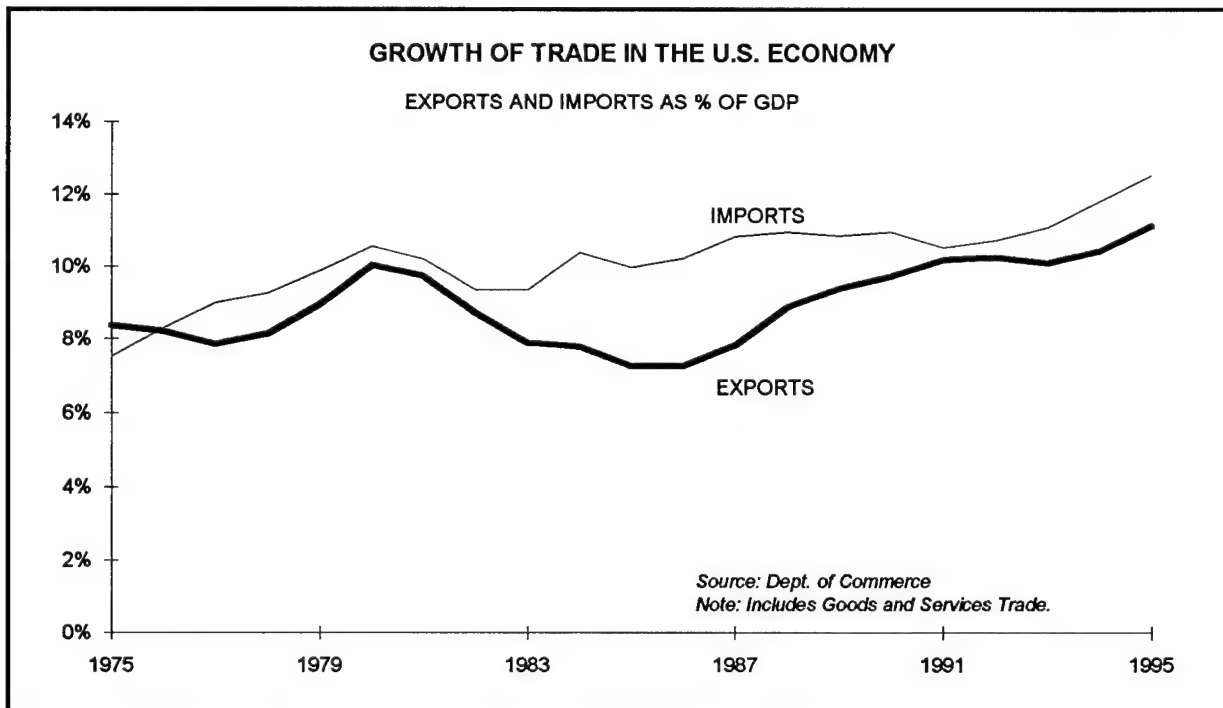
⁴ Includes goods and services trade, and is based on a comprehensive revision of the National Income and Product Accounts.

⁵ Office of the President, *Economic Report of the President*, February 1996.

⁶ U.S. Trade Promotion Coordinating Committee, *National Export Strategy*, October 1995. This report estimates that every billion dollars of exports supports 14,325 domestic jobs and that export-related jobs pay 15% more than the national average.

⁶ Department of Commerce, *The U.S. Global Trade Outlook 1995-2000*, (www.tradeport.org/ts/ntdb/usgto/).

Figure 3-A



U.S. Trade with the Asia-Pacific Region

The Asia-Pacific region is America's largest and most important trading area. The Asia-Pacific region accounted for 38% of U.S. two-way goods trade in 1995. This U.S. - Asian trade showed a strong increase of 15% from \$439B in 1994 to \$503B in 1995.⁷ (See Figure 3-B.)

- In 1995, U.S. trade with the European Union (EU) comprised only 18% of our total two-way goods trade and was half of U.S. trade with the Asia-Pacific region. In fact, U.S. trade with the Asia-Pacific region has exceeded trade with the EU since 1979.

U.S. Exports

The Asia-Pacific region is America's largest customer for exports. Exports of U.S. goods to the Asia-Pacific region amounted to \$192B in 1995, or 33% of a total \$584B.⁸ Figure 3-C shows the significant growth of U.S. merchandise exports since 1975, with exports to the Asia-Pacific region exceeding other regions.

- Japan is the second largest individual purchaser of American goods, after Canada. U.S. merchandise exports to Japan totaled \$64B in 1995. Last year, the United States exported more to Japan than to Germany, France, and the Netherlands combined.

⁷ Department of Commerce, Bureau of the Census, Electronic Bulletin Board (EBB) files EXPCTY.CEN and IMPCTY.CEN, February 1996. Census import figures do not include freight and insurance.

⁸ Department of Commerce, Bureau of the Census, EBB files EXPCTY.CEN and IMPCTY.CEN, February 1996.

Figure 3-B

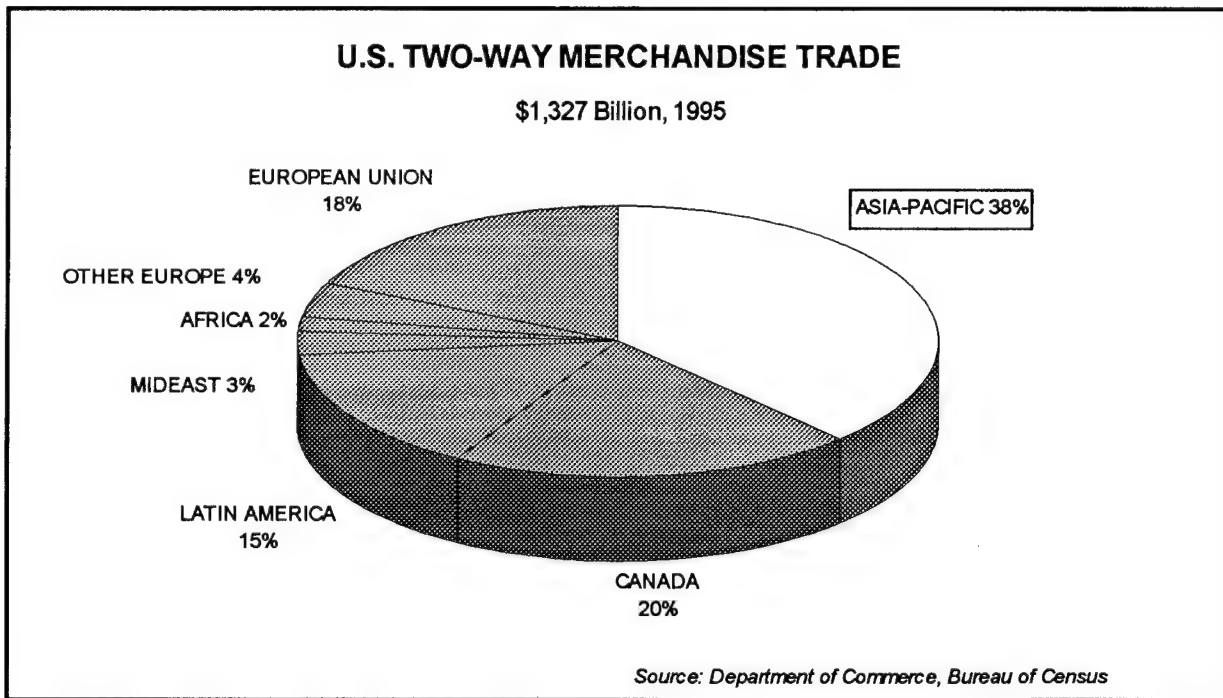
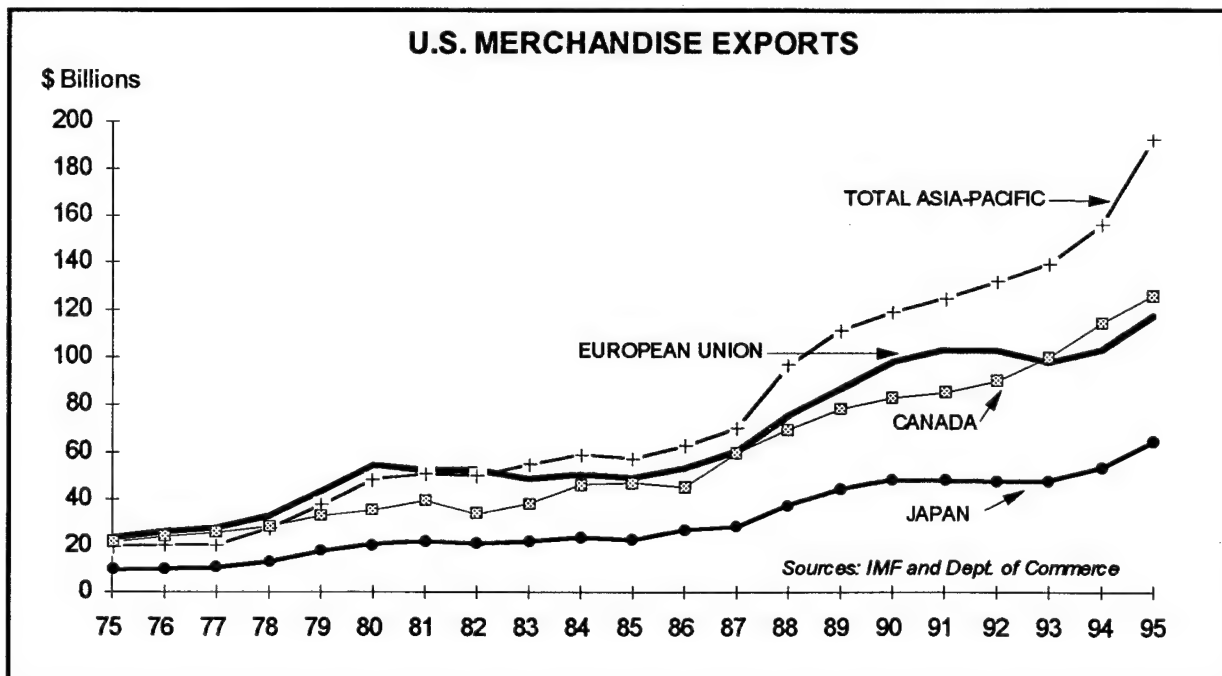


Figure 3-C



- Major U.S. exports to Japan include power industry equipment (comprising 14% of U.S. goods exports to Japan); computers and electronics (12%); and aircraft, vehicles, and parts (11%).⁹ Japan was our largest agricultural market at \$11.0B in 1995, almost twice the size of our next largest market, Canada (\$5.7B).¹⁰
- To account for differences in population and size of markets, a useful comparative measure is the volume of imports per capita. On a per capita basis, Japan's imports from the United States (\$512 per Japanese citizen) now exceed the value of America's per capita imports from Japan (\$468 per American citizen).
- The year 1995 saw a dramatic 27% increase to \$116B in U.S. merchandise exports to Developing Asia. Developing Asia buys 80% more U.S. exports than does Japan (\$116B vs. \$64B in 1995).¹¹ Developing Asian markets purchased over 25% (or \$13.9B) of U.S. agricultural exports in 1995, exceeding Japan's 20% share of that market.¹²
- Exports of U.S. services, which are measured independently of goods exports, reflect the strength of the U.S. economy in service sectors such as finance, engineering, and travel.¹³ In 1995, U.S. services exports comprised 27% of total exports. Exports of U.S. services to Japan were \$33B and to other Asian countries were \$44B.¹⁴

The U.S. National Export Strategy, first introduced in 1993, seeks to make the export process more efficient and effective by reducing export barriers and expanding markets abroad. The strategy coordinates the U.S. Government's efforts to assist American exporters through advocacy, export financing, and business counseling.¹⁵

- The centerpiece of the National Export Strategy is the Big Emerging Markets (BEMs) initiative. This initiative identifies key developing countries with large market potential. Asian BEMs include India, South Korea, the countries of Association of Southeast Asian Nations (ASEAN, or Brunei, Indonesia, Malaysia, Thailand, the Philippines, Singapore, and Vietnam), and the group of economies designated as the Chinese Economic Area (China, Hong Kong, and Taiwan).¹⁶
- In the last three years, the Departments of Commerce and State established U.S. export centers in conjunction with U.S. embassies in Asia. Several high-level trade and investment trips were made by U.S. officials in the Commerce, Energy, and State departments, facilitating multi-billion dollar deals for American energy firms in Indonesia, China, and India. Stuart Eizenstat, Undersecretary of International Trade at the Commerce Department sees a strong need for such facilitation:

⁹ Department of Commerce, National Trade Data Base, (www.doc.gov/cgi-bin/webdoc/public/ntdbdrive)

¹⁰ Department of Agriculture, Foreign Agricultural Service, "U.S. Exports of Agricultural Products," (ffas.usda.gov); and Secretary of Agriculture Daniel Glickman, *Testimony to House of Representatives Agriculture Committee*, June 5, 1996.

¹¹ Department of Commerce, Bureau of the Census, EBB files EXPCTY.CEN and IMPCTY.CEN, February 1995/1996.

¹² Department of Agriculture, Foreign Agricultural Service, "U.S. Exports of Agricultural Products," (ffas.usda.gov).

¹³ Services exports consist of business, professional, and technical services; travel; port and transportation services; and freight.

¹⁴ Department of Commerce, *Survey of Current Business*, April 1996. (Other Asia also includes a minor amount to Africa.)

¹⁵ Office of the President, *Economic Report of the President*, February 1996; U.S. Trade Promotion Coordinating Committee, *National Export Strategy Annual Report 1995*; International Trade Administration, "About ITA," (www.ita.doc.gov/ita_home/).

¹⁶ Other BEMs include South Africa, Poland, Turkey, Mexico, Brazil, and Argentina, (www.stat-usa.gov/itabems.html).

"In a sampling of over 200 overseas competitions in the past eight years, the Commerce Department estimates that U.S. firms lost approximately one half of these competitions due to political and economic pressure by other governments, including concessional financing, promises of technology transfer, and linking foreign aid flows -- totaling some \$25,000 million in lost contracts."¹⁷

- A focal point of the strategy in 1996 is the protection of sales of U.S. firms in countries that do not adequately enforce intellectual property rights (IPR). U.S. negotiators seek improved Chinese enforcement of its IPR laws on audio and movie recordings.¹⁸

U.S. Imports

The Asia-Pacific region is also America's primary source for imports. These imports provide American consumers with a variety of quality, inexpensive goods, and enable American buyers to stretch their dollar further. About \$311B of merchandise, or a full 42% of a total \$743B of U.S. goods imports, came from Asia-Pacific producers in 1995. (See Figure 3-D.)¹⁹

- Japan was our second largest single source of goods imports (\$124B) after Canada (\$145B) in 1995. Japan is a major source of U.S. imports of power industry equipment (27% of sector imports); vehicles (26% of U.S. vehicle imports); and electric machinery and electronics (23% of sector imports).²⁰
- U.S. imports from the Developing Asia region (\$182B in 1995) have exceeded imports from Japan since 1980. Major imports from Developing Asia include electric machinery and electronics; power industry equipment (reactors, boilers, machinery, and parts); toys, games, and sporting goods; and clothing.

U.S. Trade Balance

The year 1995 saw a contraction of the U.S. merchandise deficit with Japan and the rest of the Asia-Pacific region. America's overall merchandise trade deficit is highly correlated to imbalances with Asia-Pacific countries. (See Figure 3-E.) The total U.S. merchandise trade deficit was \$159.6B in 1995, at which time the United States ran a \$59.3B deficit with Japan, a \$66.6B deficit with Developing Asia countries, and a deficit of \$33.6B with the rest of the world.²¹ Accounts for U.S. services trade in 1995 ran an offsetting surplus of \$63.1B, which included a surplus of \$16.5B with Japan and \$18.8B with other Asian countries.²²

Tariff and non-tariff barriers and unfair trade practices are frequently cited as causes of U.S. bilateral trade deficits with Asian countries. While such barriers can contribute to bilateral trade imbalances, economists consider a broader set of factors, including relative savings and consumption patterns in the countries, exchange rates, business cycles, economic growth rates, foreign reserve transactions, and the composition of trade. Economically, the causes and consequences of the overall trade balance matter more than the existence of particular bilateral trade imbalances. (See Appendix B.)

¹⁷ Eizenstat, Stuart, Speech to Euroservices Conference, Washington D.C., June 18, 1996.

¹⁸ U.S. Trade Representative, *1996 Trade Policy Agenda and 1994 Annual Report*, (www.ustr.gov/reports/tpa/1996/)

¹⁹ Department of Commerce, Bureau of the Census, EBB files EXPCTY.CEN and IMPCTY.CEN, February 1996.

²⁰ Department of Commerce, National Trade Data Base, (www.doc.gov/cgi-bin/webdoc/public/ntdbdrive).

²¹ Department of Commerce, Bureau of the Census, EBB files EXPCTY.CEN and IMPCTY.CEN, February 1996.

²² Department of Commerce, *Survey of Current Business*, April 1996. ("Other Asia" includes minor amount to Africa.)

Figure 3-D

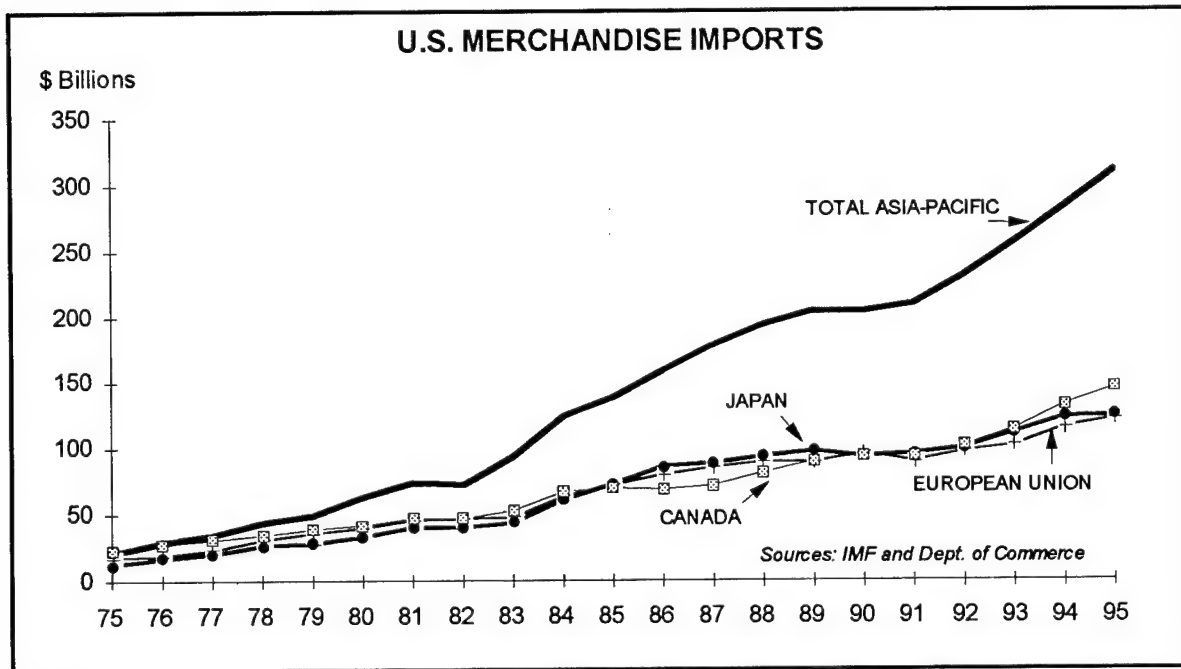
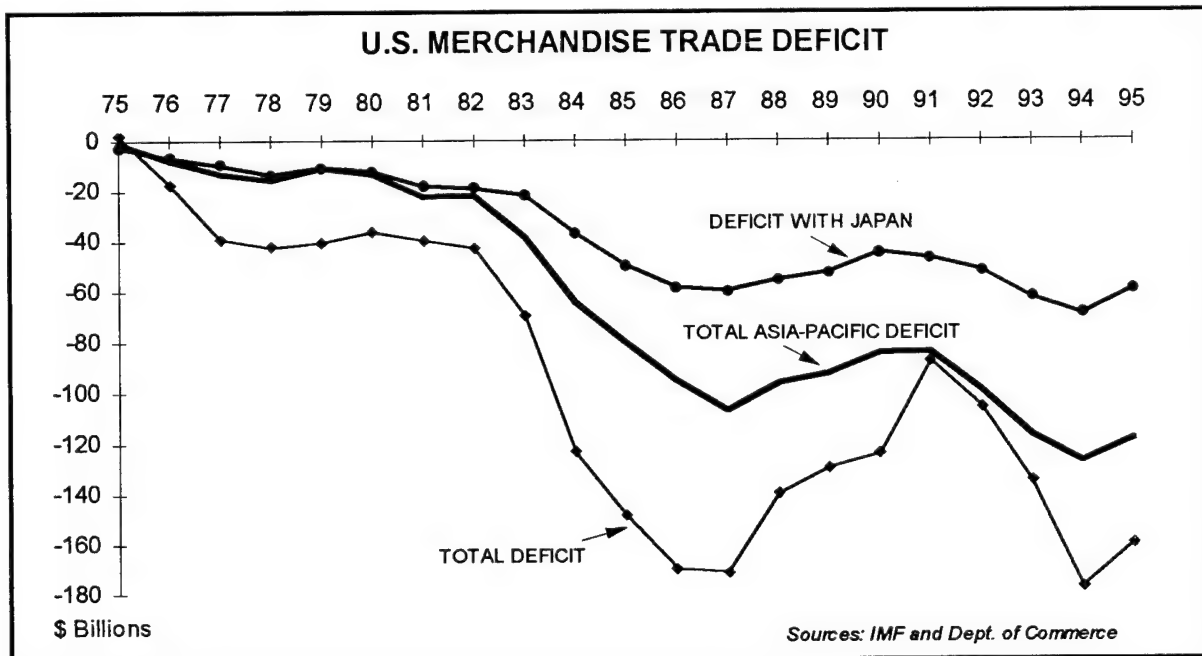


Figure 3-E



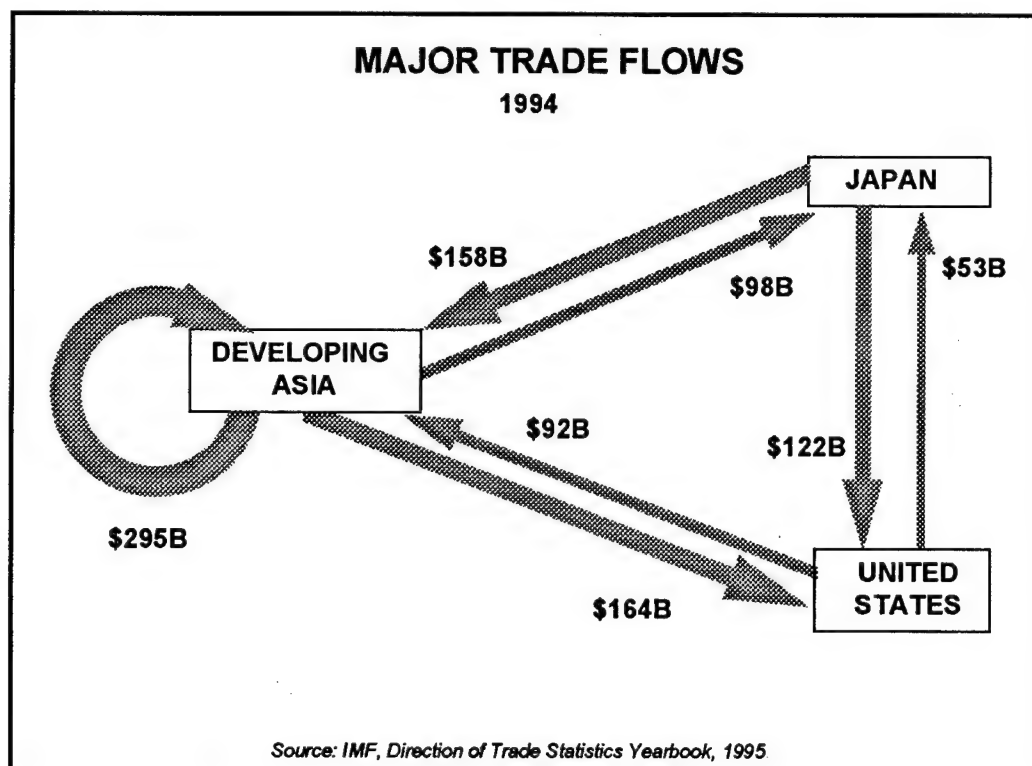
Trade in Asia

The United States, Japan, and the rest of the Asia-Pacific region are mutually dependent on open trade. All inject significant amounts of goods and services into the global trading system. The United States produces 12% of the world's exports, while Japan produces 9%, and the rest of the Asia-Pacific region produces 20%.

- In terms of the volume of their trade with the world, both Japan and the grouping of Newly Industrializing Economies (NIEs) of South Korea, Taiwan, Hong Kong, and Singapore rival the United States as global trading powers. In 1994, Japan exported \$395B to the world and the NIEs an even larger \$438B; these totals are not far behind U.S. worldwide exports of \$512B.
- The most dynamic growth of exports appears in the countries of Developing Asia (which consists of Asia-Pacific countries less the industrialized countries of Japan, Australia, and New Zealand). During the ten-year period from 1985 to 1994, the value of exports from Developing Asia grew 14% annually, while the growth of Japan's exports (9%) matched that of the world.²³

The trade of Japan, Developing Asia, and the United States reaches across the globe to many trading partners. Figure 3-F illustrates the multipolar nature of Asia-Pacific trade; it shows that neither the United States nor Japan is the single, dominant trade partner of Developing Asia.

Figure 3-F



²³ International Monetary Fund, *Direction of Trade Statistics Yearbook*, various years.

- About 22% of Developing Asia's exports go to the United States, 13% to Japan, 37% among its own countries, and 28% to the rest of the world. Japan is an important source for Developing Asia's imports (\$158B in 1994), while the United States lags behind. For example, the share of Southeast Asia's imports coming from the United States is only one-half that of Japan.
- The fastest growing component of Developing Asia's trade is its intra-regional trade, with intra-regional exports growing from \$59B in 1986 to about \$295B in 1994.²⁴

Trade opportunities will increase rapidly as Asian populations become more productive and affluent. The Organization for Economic Cooperation and Development (OECD) predicts that the developing countries of Asia will account for almost a third of global demand by 2010. By 2010, about 700 million people in China, Indonesia, and India will have average incomes equivalent to that of Spain today. This growth will have a profound impact on the world economy, with Developing Asia's economies competing aggressively in manufactures trade and absorbing a large share of investment funds. It will also provide large markets for producers in other countries.²⁵

Some Asian countries are unilaterally implementing trade liberalization and market opening measures. For example, the Philippines, Thailand, and Indonesia are establishing their own tariff reduction schedules. India has reduced tariffs, relaxed investment restrictions, and, for the first time, agreed to open its textile market.

The openness of the global trading system upon which Asian economies are so highly dependent has led to increased reliance on multilateral trade institutions. The World Trade Organization (WTO), the Asia Pacific Economic Cooperation forum (APEC), and other multilateral institutions will be quite visible in future years as Asia-Pacific economies seek to promote their own economic growth and welfare.

- The WTO was created in 1995 as a result of the Uruguay Round of trade negotiations under the General Agreement on Tariffs and Trade (GATT). The WTO provides an internationally acceptable means of arbitration for trade disputes.²⁶
- APEC leaders agreed in 1994 to create free and open trade and investment among themselves, with a goal year of 2020 for developing countries and 2010 for industrialized countries. The 1995 annual meeting held in Osaka, Japan, reinforced this agenda by detailing the agreement's timetable.²⁷ Such regional trade-agreements augment global trade liberalization, and provide a means for economic and political cooperation among members.^{28,29}

²⁴ International Monetary Fund, *Direction of Trade Statistics Yearbook*, various years.

²⁵ OECD, *Linkages: OECD and Major Developing Countries*, April 1995.

²⁶ WTO, *About WTO*, (www.wto.org/about_wpf.html).

²⁷ APEC, *APEC Information*, (www.apecsec.org.sg/agenda.html).

²⁸ WTO, *Regionalism and the World Trading System*, April 1995.

²⁹ Noland, Marcus, "Economic Trends and Issues," *1996 Asia-Pacific Senior Seminar Report*, The Asia-Pacific Center, The East-West Center, and Pacific Forum, Honolulu, April 1996; and *Implications of Asian Economic Growth*, Number 94-5, Institute for International Economics, 1994.

CHAPTER 4

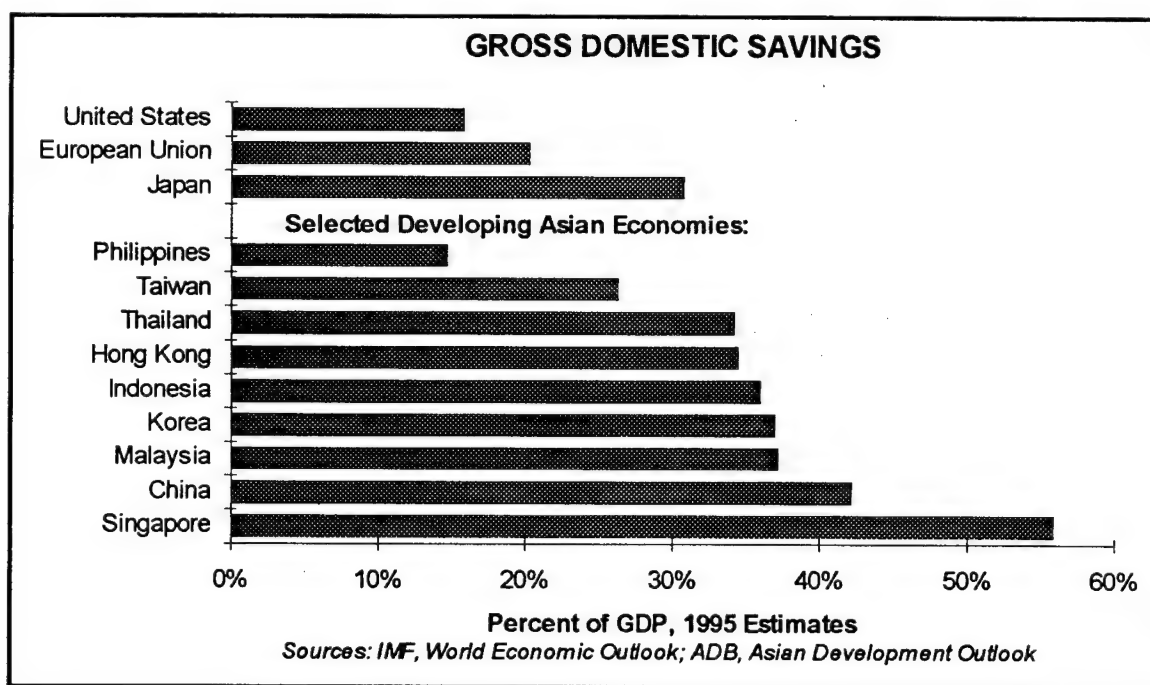
ASIAN SAVINGS AND INVESTMENT

High rates of savings and investment in Asia are largely responsible for the rapid economic growth in the region. An increasing number of Asian economies, in addition to Japan, are using excess savings and trade surpluses to invest in the region. While the U.S. economy relies on Asian capital, it is also a source of funds for Asia economies through direct investments by U.S. businesses and through U.S. portfolio investments in Asian stock and bond markets. As a result, there is a strong interdependence among U.S. and Asian economies. This chapter discusses key issues and trends with respect to savings and investment in the Asia-Pacific region.

Savings Rates

Gross domestic savings rates measure the total of government savings, household savings, and other private savings as a percentage of Gross Domestic Product (GDP). Savings, which represents deferred consumption, is available for investment in physical and human capital and lending abroad. As shown in Figure 4-A, the savings rates of Asian countries are generally higher than those of other countries.

Figure 4-A



- Japan has, by far, the highest domestic savings rate of any industrialized country (31%). In contrast, the United States has a savings rate of 16% and the European Union has a savings rate of 20%.¹

¹ IMF, *World Economic Outlook*, Table A44, May 1996.

- Singapore has the highest savings rate of any country in the world, not just Asia, with a domestic savings rate of 56% of GDP. China, the world's fastest growing economy, also has one of the world's highest domestic savings rates (42%). The savings rates of the rapidly growing Southeast Asian countries of Malaysia (37%) and Indonesia (36%) exceed the average of the Newly Industrialized Economies (NIEs) of Hong Kong, Singapore, South Korea, and Taiwan (35%).²

This Asian culture of high savings will be an increasing source of capital for the United States and the rest of the world in the next decade. Because of low American savings rates, it is likely that Asian capital will help supply a portion of the investment needed to fuel America's economic growth. However, because of the great need to finance their own infrastructure improvements, Developing Asian nations will also be competing for this capital.

Portfolio Investment in Asia

A recent and highly visible trend is the ability of Asian countries to attract foreign capital through portfolio investments by foreigners in Asian stock and bond markets.

- Global portfolio investment flows to Developing Asia countries rose rapidly from \$3.6B in 1989 to \$42.3B in 1994, but decreased to \$38.2B in 1995.³
- In 1995, portfolio investment flows from the United States to the Asia-Pacific region increased by 64% over the previous year to \$41.9B, and consisted of flows to Japan (\$23.6B), Developing Asia (\$12.8B), and Australia (\$5.5B).⁴

Foreign Exchange Reserves

Another source of capital is foreign exchange reserves, which economies accumulate to support their trade. Asia's large foreign exchange reserves are primarily the result of persistent trade surpluses, which create an inflow of foreign money from the net sale of goods and services abroad.

- The total foreign exchange reserves of the Asia-Pacific region grew by 24% during 1995 to about \$600B.⁵
- Japan and Taiwan retain the world's largest reserves, with \$183B and \$90B respectively, exceeding the reserves of Germany (\$84B) and the United States (\$75B).⁶

² Asian Development Bank, *Asian Development Outlook 1996-1997*, Table A7, April 1996.

³ World Bank, *World Debt Tables 1996*, Tables A7.1 and A7.2, March 1996; World Bank, *World Debt Tables Extracts* (www.worldbank.org/html/extpb/WDT95ENG/wdt-home.htm) March 1996. (Includes both equity and debt flows.)

⁴ Department of Commerce, *Survey of Current Business*, Table 10, April 1996. (Developing Asia also includes small amounts to Africa.)

⁵ *Far Eastern Economic Review*, April 25, 1996 and March 9, 1995; IMF, *World Economic Outlook*, Table A36, May 1996.

⁶ *The Economist*, "Financial Indicators" and "Emerging Market Indicators", April 22, 1995.

Direct Investment in Asia

A traditional source of capital for economic development is direct investment, which is the flow of international capital that occurs when a firm in one country creates, acquires, or expands a subsidiary in another country.^{7,8} Asia is an attractive destination for direct investment by foreign corporations for a number of reasons. First and foremost is the sustained economic growth in the region since the early 1980s. Second, growth in many Asian economies has led to the liberalization of economic policies, particularly those related to direct investment. The result has been increasingly market-based, open economic systems. Companies that invest in the region, particularly in East Asia, gain access to skilled, inexpensive labor and large, local markets.⁹ Foreign corporations are not the only ones who profit from direct investment. Host nations gain a fresh source of capital, tax revenue, jobs, and access to technology.¹⁰

- During 1995, Developing Asia received 62% of foreign direct investments (or \$56B out of a total annual flow of \$90B) going to developing countries.¹¹
- China is by far the largest recipient of foreign direct investment (\$38B, or 42% of the total investment in developing countries in 1995). In fact, the annual amount of foreign direct investment in China now exceeds the cumulative foreign direct holdings in Japan.
- The next largest Asian recipients of direct investment are Malaysia, Singapore, Thailand, and Indonesia. Newly developing economies such as India and Vietnam are likely to receive more direct investment in the future.
- Minimal foreign direct investment goes into Japan; foreigners held a cumulative total of only \$38.0B in direct investments in 1995.¹² In the past, Japan deliberately frustrated foreign efforts to invest domestically through strict regulation and other non-regulatory barriers. High land prices, labor and business costs, and informal impediments to business have severely constrained foreign direct investment in Japan. The recent slow growth of the Japanese economy has further discouraged investment.
- The attractiveness of foreign investment in Asia is attributed to a low risk environment. Michael Walton, Chief Economist for the World Bank's East Asia and Pacific Region comments that,

⁷ Krugman, Paul and Maurice Obstfeld, *International Economics: Theory and Policy*, Third Edition, 1994.

⁸ Mataloni, Raymond, Jr., "A Guide to BEA Statistics on U.S. Multinational Companies," *Survey of Current Business*, March 1995. A more technical definition is: "Direct investment is investment in which a resident of one country obtains a lasting interest in, and a degree of influence over management of, a business enterprise in another country. In the United States, the criterion used to distinguish U.S. direct investment abroad from other types of investment abroad is the ownership of at least 10% of a foreign business enterprise."

⁹ East Asia refers to: China, Hong Kong, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan, and Thailand.

¹⁰ Mason, Mark, *Foreign Direct Investment in East Asia: Trends and Critical U.S. Policy Issues*, Council on Foreign Relations Asia Project Working Paper, November 1994.

¹¹ World Bank, *World Debt Tables 1996*, Tables 1.4 and A6.1, March 1996; World Bank, *World Debt Tables Extracts*, (www.worldbank.org/html/extpb/WDT95ENG/eap.html), March 1996.

¹² Japan Ministry of Finance, Japanese Direct Investment, (www.mof.go.jp/english/files.htm), July 1996.

"Foreign direct investment has surged in East Asia thanks to rising opportunities, low risks, and a take-off in flows from overseas Chinese and Korean investors, which accounted for more than half the total in 1994. The rising opportunities and low risks are largely tributes to past policy: firm macroeconomic management, good infrastructure, an increasingly skilled industrial labor force, and rising international integration have provided the basis for a powerful, investment-driven growth dynamic."¹³

Intraregional Direct Investment

Intraregional direct investment, or Asian investment in Asia, is the fastest growing component of direct investment in the region. Japan remains the largest investor in Asia; however, the Newly Industrialized Economies have become major investors as well. After more than a decade of consistently high growth, the NIEs have reached a stage in their development where they can invest outward, and they have done so at a very fast pace. Hong Kong and Taiwan are primary investors in China. South Korea is a major investor in ASEAN countries. By 1993, over half of the foreign direct investment holdings in East and Southeast Asia originated from within the Asian region.¹⁴

Japan's Direct Investment in Asia and the World

Today, Japan is the largest foreign investor in most Asian nations. (See Figure 4-B.) A typical pattern has been Japanese investment in regional, labor-intensive industries that produce intermediate goods for export back to Japan, where the final product is manufactured for export to third countries such as the United States. However, Asian affiliates of Japanese firms increasingly sell their products to local or Japanese markets.¹⁵ Asian sectors that Japan has invested in include electric machinery; chemicals; transportation; metals; textiles; trade and sales; services; banking, finance, and services; and real estate.¹⁶ Over the last decade, the strong yen has provided an incentive for Japan to continue its investment flow to Asia, as corporations reduce costs by moving labor-intensive assembly and manufacturing industries out of Japan.

- Japan's holdings in Developing Asia have exceeded American holdings since about 1984. (See Figure 4-C.) In fact, the flow of investment from Japan to Developing Asia since 1989 has exceeded total cumulative U.S. investments there. In 1995, Japan's holdings in the Developing Asia region were \$89.0B; holdings in Australia and New Zealand totaled \$30.1B. Meanwhile, U.S. holdings in Developing Asia totaled \$57.5B.¹⁷
- It is important to emphasize that Japan has invested on a global basis. Japan's investment holdings in Europe (\$99B) were only slightly less than its holdings in the Asia-Pacific region (\$119B) during 1995. The United States remains Japan's largest destination for investment, although the estimate varies according to source: Japanese sources indicate \$218B (or 42% of Japan's total investments of \$516B),¹⁸ while the U.S. estimate, which is based on actual rather than planned figures, is a considerably smaller \$109B.¹⁹

¹³ World Bank, *Press Release No. 96/23/EAP*, (www.worldbank.org/html/extme/9623eap.html), March 12, 1996.

¹⁴ Asian Development Bank, *Asian Development Outlook 1996-1997*, May 1996.

¹⁵ Noland, Marcus, *Implications of Asian Economic Growth*, Number 94-5, Institute for International Economics, 1994.

¹⁶ Japan Ministry of Finance, Japanese Direct Investment, (www.mof.go.jp/english/files.htm), July 1996.

¹⁷ Japan Ministry of Finance, Japanese Direct Investment, (www.mof.go.jp/english/files.htm), July 1996; Japan Economic Institute, *JEI Report*, July 7, 1995; Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

¹⁸ Japan Ministry of Finance, Japanese Direct Investment, (www.mof.go.jp/english/files.htm), July 1996. Investments for 1995 use conversion rate of 94.1 yen per dollar (IMF, *World Economic Outlook*, Table A19, May 1996).

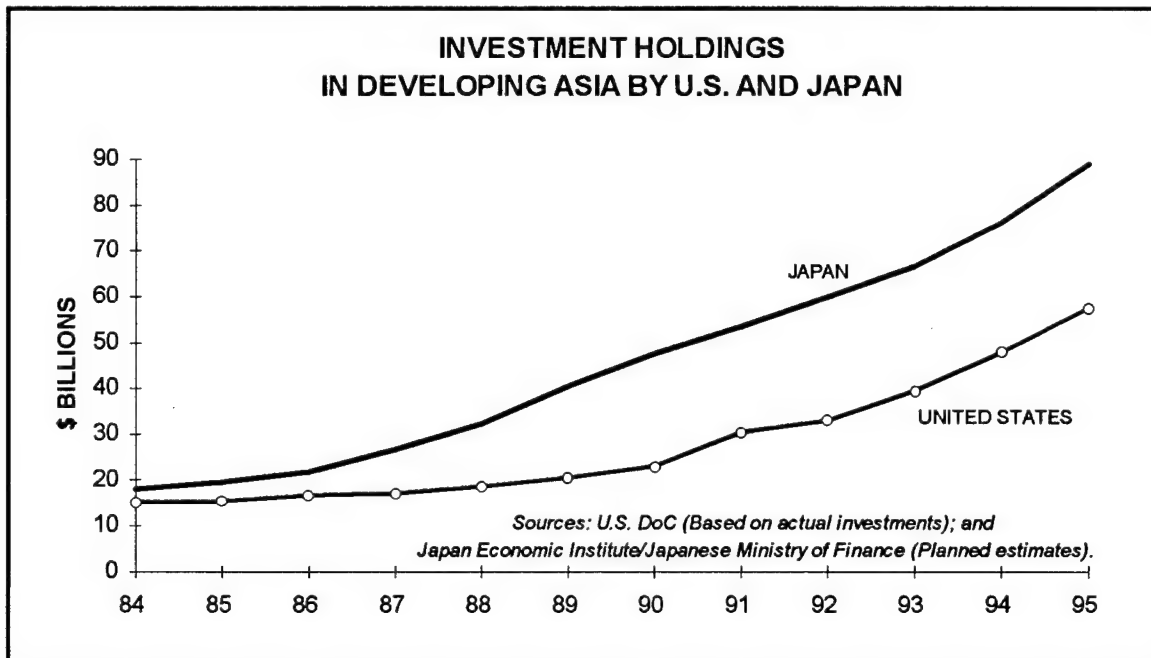
¹⁹ Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

Figure 4-B

**DIRECT INVESTMENT HOLDINGS IN DEVELOPING ASIA
BY UNITED STATES AND JAPAN (\$Billions)**
(Cumulative through 1995)²⁰

<u>In</u>	<u>By U.S.</u>	<u>By Japan</u>
China	2.0	13.3
Hong Kong	13.8	15.1
Indonesia	7.1	18.7
Korea, South	5.3	5.8
Malaysia	3.7	7.0
Philippines	2.6	3.5
Singapore	12.6	10.7
Taiwan	4.4	4.5
Thailand	4.6	8.5
<u>Other Dev. Asia</u>	<u>1.4</u>	<u>1.9</u>
Developing Asia Total	57.5	89.0
In United States	—	109.0
In Japan	39.2	—

Figure 4-C



²⁰ Japan Ministry of Finance, Japanese Direct Investment, (www.mof.go.jp/english/files.htm), July 1996; and Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996, (Note that U.S. investments are defined to include only actual transactions, whereas Japanese sources show figures based on broader, planned estimates of investments during the year, some of which may not actually occur. Also, Commerce Department's direct investment figures are given, for individual countries, on a historical cost basis only, which tends to undervalue investments.)

U.S. Direct Investment in Asia

The U.S. government has placed an increased emphasis on investment to facilitate access to foreign markets and will focus on investment issues in future trade negotiations. Foreign investment has been seen as a substitute for international trade, but is now being viewed as a complement or even a necessary component of trade.²¹ This emphasis on investment is particularly relevant in Asia, where American companies abroad are being established in dynamic Asian markets. These investments then serve as conduits for the inflow of American goods and services.

The United States has been steadily increasing its holdings in Asia over the last several decades, in both absolute terms and as a share of total U.S. direct investment. Recently, the recovery of the U.S. economy has encouraged U.S. businesses to expand further into Asia.

- Cumulative U.S. direct investment in the Asia-Pacific region increased from \$45B in 1987 to \$126B in 1995. The annual flow of U.S. investment to the Asia-Pacific, which during 1981 was \$2B, increased nine-fold to a flow of \$18B during 1995.
- U.S. holdings in Developing Asia (\$57.5B in 1995) are invested in the manufacturing, petroleum, and wholesale trade sectors. U.S. holdings in Japan total \$39.2B. Other significant sites for investment are Australia (\$24.7B), Hong Kong (\$13.8B), Singapore (\$12.6B), and Indonesia (\$7.1B). China currently receives only a small portion of U.S. direct investment (\$2.0B).²²
- While U.S. investment holdings are primarily in Europe (51% of a total \$712B), the share of U.S. investments in Asia-Pacific nations (18%) grew to exceed those in Latin America (17%) in 1995.

Asian Direct Investment in the United States

Japan has a strong presence in the U.S. economy not only with respect to trade, but also in direct investment holdings. In 1992, Japan became the largest holder of direct investments in the United States, but lost this position to the United Kingdom in 1994. In 1995, Japan held 19% of the U.S. total (\$108.6.1B out of \$560.1B), while the United Kingdom held 24% (\$132.3B).²³

- The annual flow of investment from Japan to the United States decreased significantly during the Japanese recession in 1993, but increased to an annual flow of \$4B during 1994 and 1995.
- Other Asia-Pacific nations with significant U.S. holdings are Australia (\$7.8B in 1995), Taiwan (\$2.1B), South Korea (1.9B), Hong Kong (\$1.4B), and Singapore (\$1.3B).

²¹ Office of the President, *Economic Report of the President*, Transmitted to the Congress, February 1996.

²² Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

²³ Department of Commerce, *Electronic Bulletin Board File: INT-INV.BEA*, July 2, 1996.

CHAPTER 5 FOREIGN AID

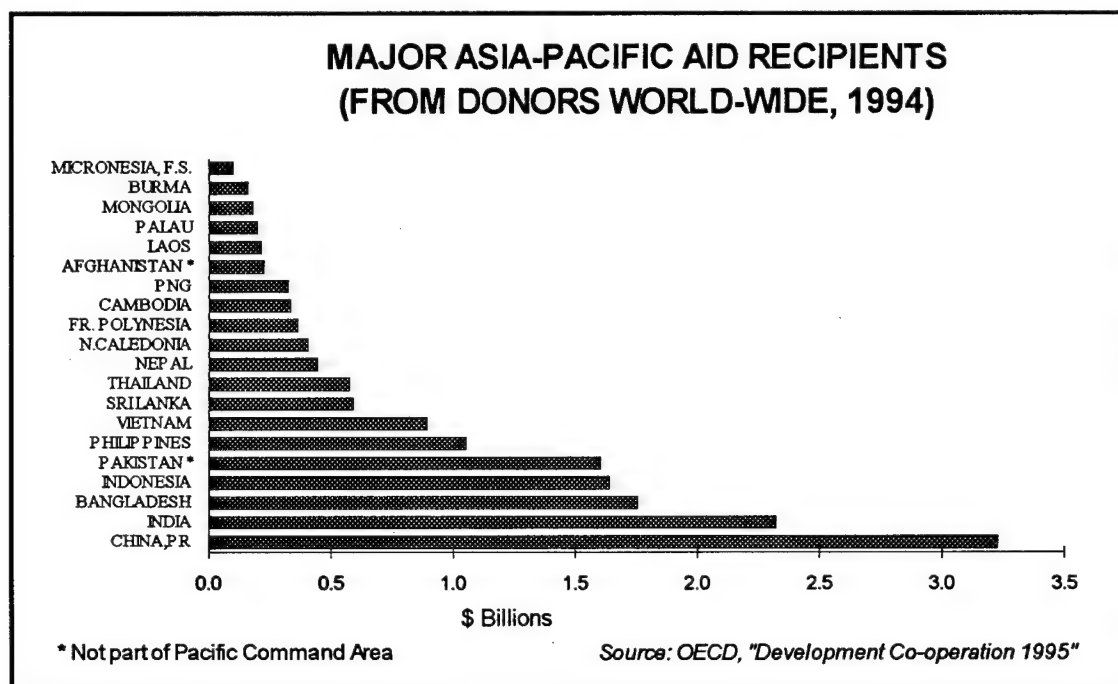
In contrast to private sector trade and investment, foreign aid programs are discretionary policy tools available to governments to influence international relations and enhance the economic well-being and security of friends and allies. This chapter identifies Asian aid recipients and describes key patterns of aid from Japan and the United States.

Aid Recipients

Although Asian economies have shown major strides in development, Asia still accounts for half of the world's poor. Therefore, a significant demand for foreign aid in Asia still exists.

- Aid donors allocate funds to economic infrastructure (28% of total world-wide aid), social and administrative infrastructure (27%), sectoral production (15%), program assistance (9%), food aid (2%), and other miscellaneous programs (19%).¹
- In 1994, Asian nations that received assistance of over \$1.0B were China (\$3.2B), India (\$2.3B), Bangladesh (\$1.8B), Indonesia (\$1.6B), Pakistan (\$1.6B), and the Philippines (\$1.1B), as shown in Figure 5-A.² The Pacific Islands as a group received \$1.8B in 1994.
- A new aid strategy was proposed in 1996 by the Development Assistance Committee (DAC), a consortium of industrialized, aid-donating countries, that sets a goal of reducing the number of people living in poverty to half the current level of 1.3B by the year 2015.³

Figure 5-A



¹ Organization for Economic Cooperation and Development (OECD), *Development Co-operation 1995*, Table 26.

² OECD, *Development Co-operation 1995*, Table 33 (www.oecd.org/dac/htm/dacstats.htm).

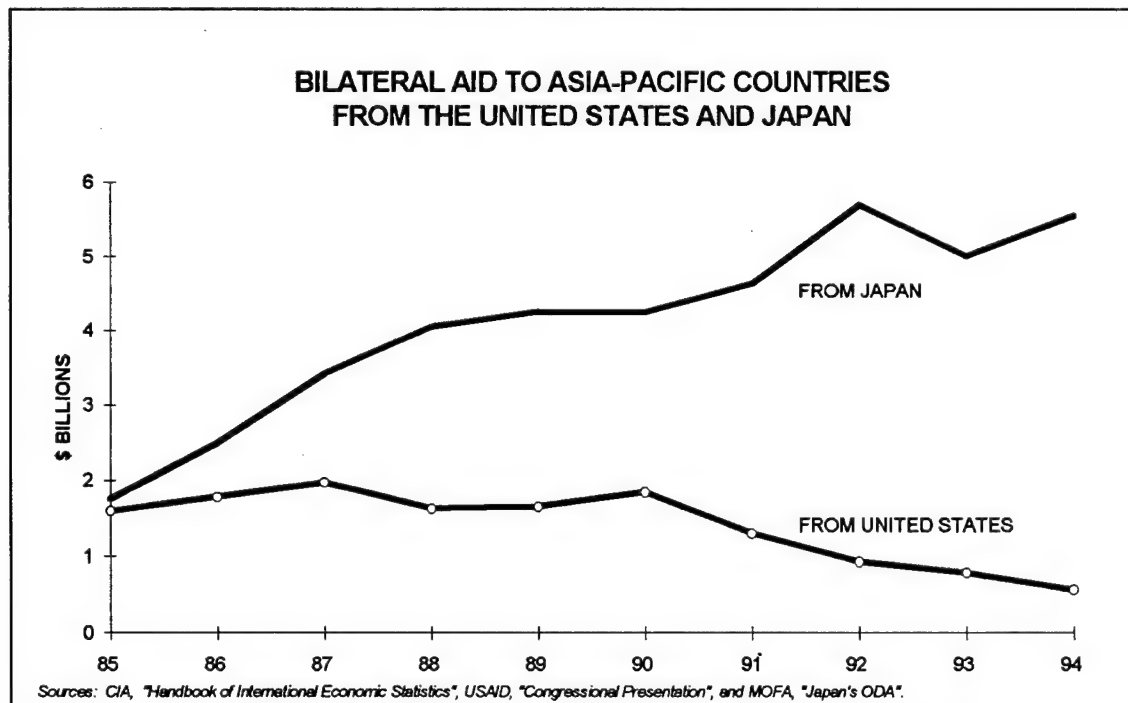
³ OECD, *OECD News Release*, May 7, 1996 (www.oecd.org/news_and_events/release/nw96-44a.html).

U.S. and Japanese Aid to Asia

Japan is the world's largest contributor of aid, followed by France, Germany, and the United States. In general, Japan's aid concentrates on Asia, while U.S. aid goes to the Near East.

- In 1995, Japan provided \$14.5B in world-wide aid, followed by France (\$8.4B), Germany (\$7.5B), and the United States (\$7.3B). Another standard measure of a country's capability and willingness to pay for foreign aid is the amount of foreign aid as a percent of GDP. The United States contributed 0.10% of GDP to foreign aid; Japan devoted 0.28%; and the DAC donor average was 0.27%.⁴
- Japan is the largest donor of aid to Asia and targets most of its aid to that region. About 63% of Japan's total aid went to Asia in 1994, including contributions to multilateral aid organizations.⁵ In 1994, Japan's bilateral aid to Asia was \$5.6B.⁶ (See Figure 5-B.)

Figure 5-B⁷



- U.S. bilateral aid to Asia was \$0.6B in 1994, which was one-ninth that of Japan. In 1995, Asia received 4% of total U.S. economic and military assistance obligations of \$12.7B. In contrast, the Near East and the Newly Independent States (NIS) received 53% of U.S. assistance in 1995.⁸ (See Figure 5-C.)

⁴ OECD, *OECD News Release*, June 11, 1996, (www.oecd.org/news/release/).

⁵ OECD, *Development Co-operation 1995*, Table 41.

⁶ Ministry of Foreign Affairs, Japan, "Japan ODA Summary 1995," (www.nttl.co.jp/infomofa/oda/sum1995).

⁷ USAID; OECD; CIA, *Handbook of International Economic Statistics*; and Ministry of Foreign Affairs, Japan, *Japan's Official Development Assistance (ODA) Annual Report 1994*.

⁸ Agency for International Development (USAID), *Congressional Presentation, Summary Tables, FY 1996, Part II*.

Note: In contrast to foreign aid figures presented by the Development Assistance Committee (DAC), U.S. government statistics also include military and other forms of assistance. Aid shown in Figure 5-C includes foreign military financing (FMF) arrangements, primarily with Israel (\$1.8B) and Egypt (\$1.3B). No FMF existed with Asia-Pacific countries in 1995.

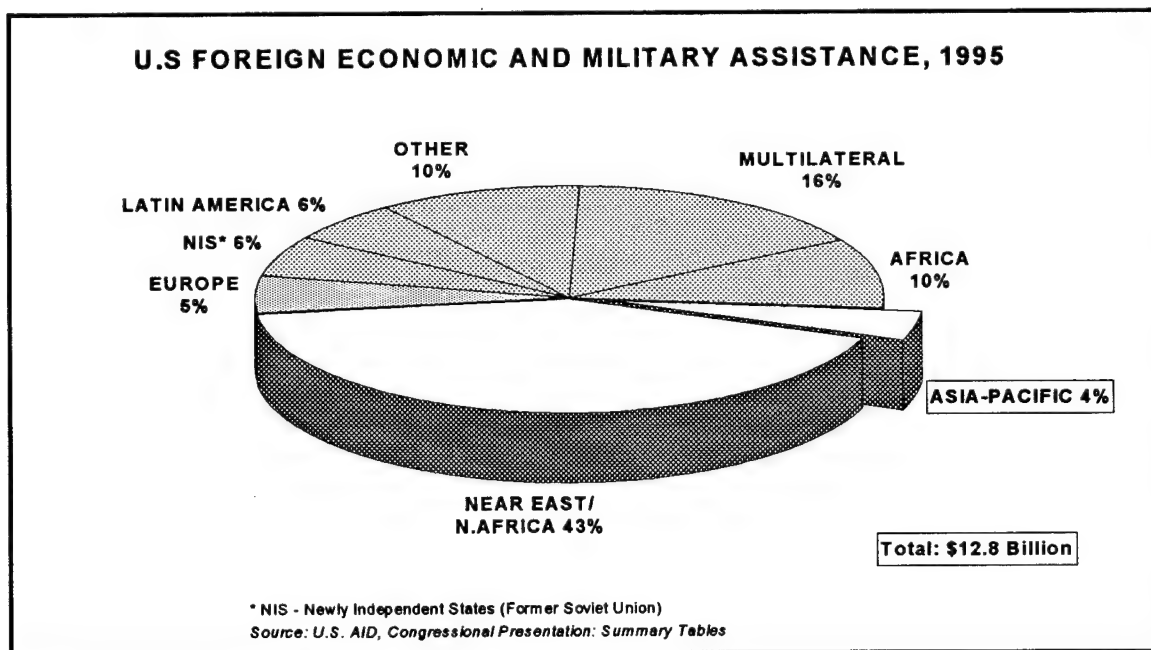
U.S. Assistance Programs

U.S. economic aid to Asia provides the technical assistance and training necessary to develop the foundations for stable, free market economies and helps create the legal, regulatory, and economic policy frameworks that enable productive foreign investment and trade. The United States now emphasizes five objectives: economic development, democracy, humanitarian assistance, and most recently, population and the environment. Emphasis is being placed on the role of nongovernmental organizations (NGOs) that promote labor and human rights objectives.

Part of Asia's massive requirement for improving its infrastructure will be met through aid programs. U.S. firms have strong skills in the development of public infrastructure (power, communications, transportation, etc.), and could be more closely tied to aid projects in the future. U.S., Japanese, and other bilateral and multilateral aid programs can offer strong commercial opportunities for American firms in Asia.

Security assistance, in the form of International Military Education and Training (IMET) programs, is a key component of USCINCPAC's Cooperative Engagement Strategy with Asia-Pacific countries. In 1995 U.S. IMET to Asia totaled \$4M, or 1% of U.S. aid to Asia.⁹

Figure 5-C



⁹ USAID, *Congressional Presentation, Summary Tables, FY 1996, Part II.*

Japan's Aid Program

Japan's patterns of aid distribution have varied over time and by region, and are based on Japanese foreign policy interests, as well as economic interests. An important factor in Japan's sizable foreign aid program is its ability to draw upon its large foreign trade surplus.

- While Japan spent one percent of its GNP on defense, it devoted 0.28% to foreign aid in 1995. In contrast, the United States spent 0.10% of its GNP on foreign aid, and 4.8% on defense in 1995.¹⁰
- In 1992, Japan adapted guidelines for aid under an "Official Development Assistance (ODA) Charter" as part of its foreign policy concept of "comprehensive security." The ODA Charter seeks compatibility between environmental and developmental objectives, avoidance of the use of ODA funds for military purposes, monitoring of military expenditures and arms trading, and promotion of democratization, human rights, and market-oriented economic policies.¹¹
- Japan places few formal conditions on recipient countries. In contrast, most other donors, including the United States, usually require conditionality from recipients in terms of desired economic reforms, including improved management of debts, budget and trade deficits, and increased privatization.¹²
- In practice, Japan's aid primarily emphasizes informal economic ties between recipient countries and Japanese industry. The stereotype of Japan's official development assistance (ODA) program is that it provides infrastructure projects in developing countries, and that these projects are contracted out primarily to Japanese construction companies. However, the informal ties between Japanese aid and Japanese industry are loosening. The governments of Japan and the United States are coordinating efforts to increase the opportunities for American corporations to compete for Japanese aid contracts.¹³
- Japan's comprehensive security approach is based not only on military factors and access to resources and trade, but also on the recognition that the economic development and political stability of developing countries, especially those of Asia, are important to Japan's well-being.

¹⁰ OECD, *Development Co-operation 1995*; U.S. Department of Commerce, *Survey of Current Business*, April 1996.

¹¹ Ministry of Foreign Affairs, Japan, "Japan ODA Summary 1995", (www.nttl.co.jp/infomofa/oda/sum1995).

¹² Koppel, Bruce, *Japan's Foreign Aid: Power and Policy in a New Era*, Westview Press, Boulder, Colorado, 1993.

¹³ U.S. Department of Commerce, International Trade Administration, "Information About the Untied Aid Initiative," (www.ita.doc.gov/industry/sif/sifuai/ininfo.html).

SECTION III

ECONOMICS AND SECURITY LINKAGES

"...the United States remains an indispensable factor in any new configuration for peace, security and economic growth in the Asia-Pacific. Only the United States has the strategic weight, economic strength and political clout to hold the ring in the Asia-Pacific."

*Foreign Minister S Jayakumar of Singapore
Speech at Georgetown University, Washington,
April 1996*

"Remember that both economics and security are important, and that they are linked."

*Kent E. Calder, Director, Program on U.S.-Japan
Relations, Princeton University, "Pacific Defense:
Arms, Energy and America's Future in Asia"*

CHAPTER 6

ENERGY IN THE ASIA-PACIFIC REGION

The rapid growth of the Asia-Pacific economies has generated added pressure on the region's demand for energy. This chapter assesses current energy requirements and provides an outlook for energy demand, supply, and security in the Asia-Pacific region.

Asia's Growing Energy Demand

Asia will be at the center of the world's future energy needs. Energy demand in Asian Developing Countries is expected to grow 4.3% per year through 2015, well above the average 2.8% for developing countries.¹

Asia's rising demand for energy presents a strong growth opportunity for American energy expertise and technology.

- A 10% share of the \$300B Asian market for new power generation capacity would translate into \$30B in U.S. exports supporting an estimated 60,000 U.S. jobs over the next 7 years.
- China's overall energy demand is projected to more than double by 2015, requiring as much as \$1T in investment spending. Major investments in the electric power sector are required, and American experience with clean coal technology is in demand. The United States already is realizing gains from trade and investment in China's energy sector. U.S. exports of electric power systems to China rose from \$1.0B in 1994 to \$1.2B in 1995. In early 1995, the Energy Department witnessed the signing of \$4B in energy deals between U.S. and Chinese companies.²

Predominance of Oil

Oil is currently the dominant source of energy for the Asia-Pacific region, excluding China, which relies more heavily on coal.

- Oil accounted for most of the region's energy consumption (51%) in 1994, followed by coal (27%), natural gas (13%), nuclear energy (7%), and hydroelectricity (2%), when excluding China.³ The Asia-Pacific region's reliance on oil in energy consumption is above the world average share of 40%, as shown in Figure 6-A.
- In China, oil accounted for only 19% of commercial energy consumption in 1994; coal predominated, accounting for 76% of demand.⁴
- Total oil demand by the Asia-Pacific region (including China) is larger than that of Europe and is second only to that of the United States. U.S. oil demand in 1995 was 17.7 million

¹ EIA, *International Energy Outlook 1996*, May 1996 (www.eia.gov/oiaf/ieo96/WORLD.html).

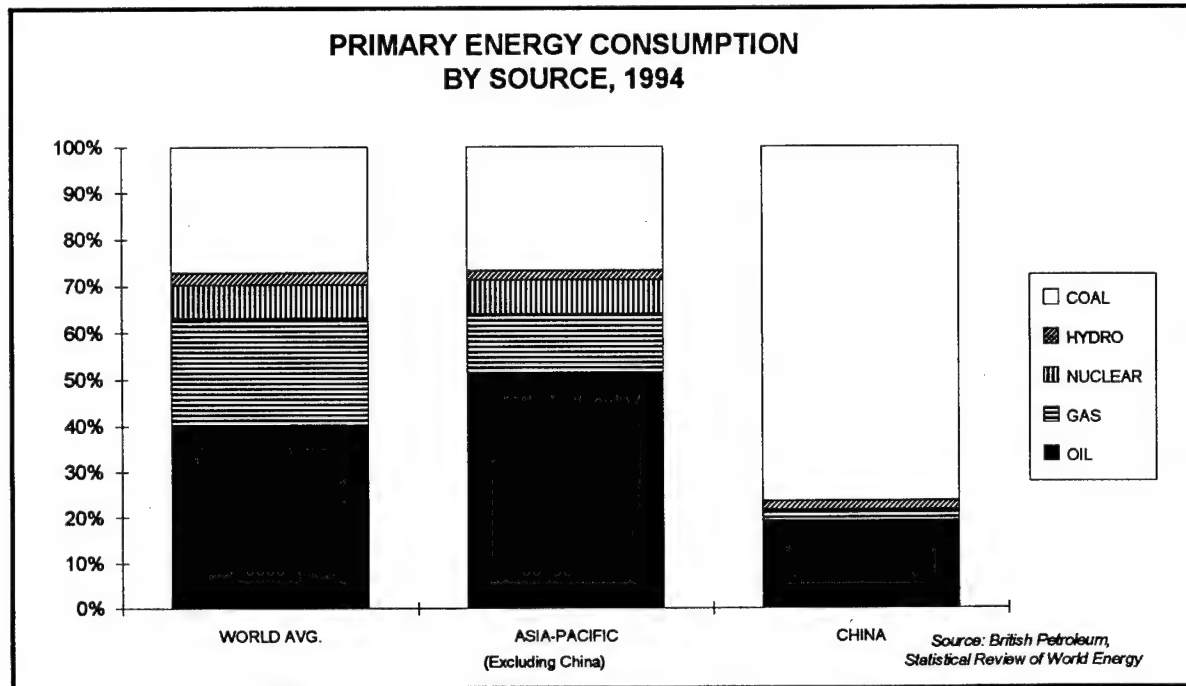
² EIA, *Country Analysis Briefs 1996* (www.eia.gov/emeu/cabs/china.html).

³ British Petroleum Co., *Statistical Review of World Energy 1995*, June 1995 (www.bp.com/statdata.html).

⁴ British Petroleum, *ibid*.

barrels per day (MMBD), compared to the Asia-Pacific's 17.2 MMBD and West Europe's 13.8 MMBD. In 1995, Japan accounted for 33% (or 5.7 MMBD) of Asia-Pacific oil demand, and China 19% (or 3.3 MMBD).⁵

Figure 6-A



Oil Import Dependence

As the region enters the 21st century, oil will continue to be a critical form of energy. Oil demand in the region is now projected to rise from 17.2 MMBD in 1995 to 20.9 MMBD by the turn of the century, as shown in Figure 6-B.⁶

Asia-Pacific crude oil production is increasingly unable to address regional oil demand. Asia accounted for only 10% of the world's oil production of 69.6 MMBD in 1995, but about 25% of world demand. Further, the region is rapidly drawing down its supply of known reserves. Given the fast economic growth in the region, the dependence of the Asia-Pacific region on oil imports will increase.⁷

- The region's crude oil production reached 7.0 MMBD in 1995, and is not expected to change significantly for the rest of the decade.⁸
- The Asia-Pacific region is estimated to possess only 4% of the world's oil reserves. As a rough measure of how long Asia-Pacific energy sources may last, the region's reserves to

⁵ EIA, *International Petroleum Statistics Report*, Table 2.4, April 1996 (www.eia.gov/emeu/ipsr/t24.txt), and East-West Center energy database, May 1996.

⁶ East-West Center energy database, May 1996.

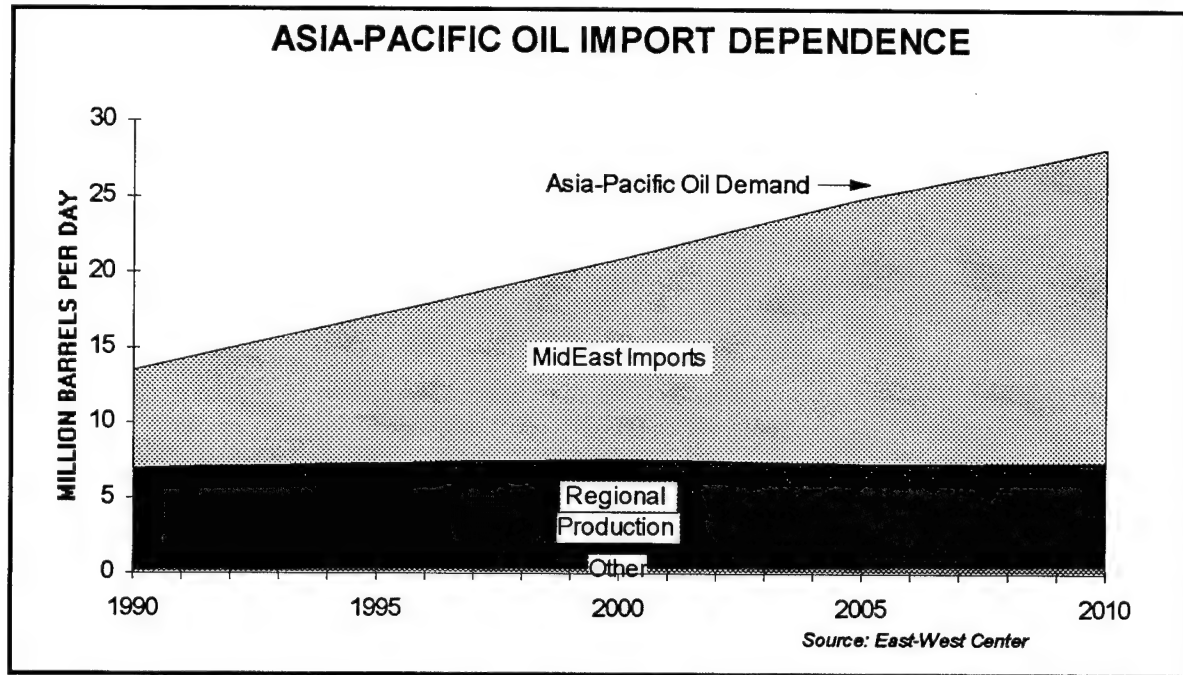
⁷ Fesharaki, Fereidun, Allen L. Clark, and Duangjai Intarapavich, *Pacific Energy Outlook: Strategies and Policy Imperatives to 2010*, March 1995, East-West Center.

⁸ East-West Center energy database, May 1996.

production ratio of 18 years is far less than the world average of 43 years and the Middle East average of 93 years.⁹

- In 1995, 61% of the oil consumed in the region was imported. By 2000, import dependence will rise to 67% and by 2010 to 77%. Figure 6-B reveals the growth of oil imports while regional production remains unchanged.¹⁰

Figure 6-B



Oil dependence on Middle East sources will grow. Non-oil producing countries of the region will continue to experience bilateral deficits in their balance of payments with oil producing countries. For example, the Philippines will most likely need to continue exporting labor overseas to Arabian Gulf states to help pay for oil imports. Further, the Asia-Pacific region will experience increased dependence on political stability in the Middle East and the security of transit routes.

- The Middle East supplies over half of the oil demand of the Asia-Pacific region. In 1995, the Middle East supplied 56% of the Asia-Pacific region's total oil consumption, and is projected to supply 63% in 2000, and 74% in 2010.¹¹
- For individual countries, the share of Persian Gulf oil in total oil consumption is high for Japan (67%) and South Korea (74%). When adding oil refined by Singapore - which is primarily obtained from the Middle East - to oil imports coming directly from the Middle East, other countries showing high dependencies on Middle East oil include the Philippines (85%), Taiwan (61%), and Thailand (48%). Similarly, about 8% of China's

⁹ British Petroleum, *ibid.* (Please note: The reserves to production ratio represents the total stock of the known reserves divided by the rate at which it is currently drawn down; the result is the time, in years, until depletion. However, substantial additions to reserves are likely as a result of continued active exploration in the Asia-Pacific region.)

¹⁰ East-West Center energy database, May 1996.

¹¹ East-West Center energy database, May 1996.

and 20% of Australia's oil consumption is supplied directly by Middle East oil import or by way of Singapore refineries.¹²

- The region's dependence on Arabian Gulf oil sharply contrasts with the United States, where Venezuela, Canada, Mexico, and the North Sea will remain key external sources for the U.S. energy market. Nevertheless, the United States will also be increasing its oil imports in the future. The Energy Information Administration (EIA) estimates that 57% of all oil consumed in the United States in 2010 will be imported, compared to 47% in 1995.¹³

China's oil demands are growing and outstripping its domestic oil production. China will be increasingly reliant on external sources for oil. The Middle East will continue to be China's primary source of externally-supplied oil. China became a net oil importer in 1994 despite its attempts to limit oil imports.

- China's partial reliance on the transit of Middle East oil through the Indian Ocean and the straits of Southeast Asia will be significant to China's approach to international relations and may be a motivating factor behind China's desire to expand and modernize its navy.
- While China and other countries hope to find oil in the Spratly Islands in the South China Sea, the economic importance of the Spratlys is easily overstated. Most sites for oil and gas are anticipated to be found along coastal areas, within Exclusive Economic Zones of countries along the periphery of the South China Sea. Under optimistic assumptions, the oil potential of the Spratly Islands is modest, at no more than 200 to 300 million barrels, equating to the reserves of Brunei.¹⁴

Asia's lengthy shipping lanes are among the most vulnerable in the world because of piracy and their proximity to the waters of several nations. Shipping lanes are especially vulnerable in the straits of Southeast Asia, posing a potential threat to Asia's access to Middle East oil and European and American markets.

Energy Reserves

A comparison of sources of energy reveals that coal is a vastly more abundant energy resource than oil. Although oil is a primary source of energy for today's global economy, coal will be a major source for generations to come.

- The abundance of coal can be seen in the ratio of proven reserves to production. At present production rates, the world's reserves will last 43 years for oil, 66 years for natural gas, and 235 years for coal.¹⁵

¹² Blackwell Energy Research, *World Oil Trade*, September 1995; British Petroleum, *Statistical Review of World Energy 1995*, June 1995, (www.bp.com/statdata.html); EIA, *International Petroleum Statistics Report*, Table 4.11, April 1996 (www.eia.gov/emeu/ipsr/t411.txt); and East-West Center Energy Database.

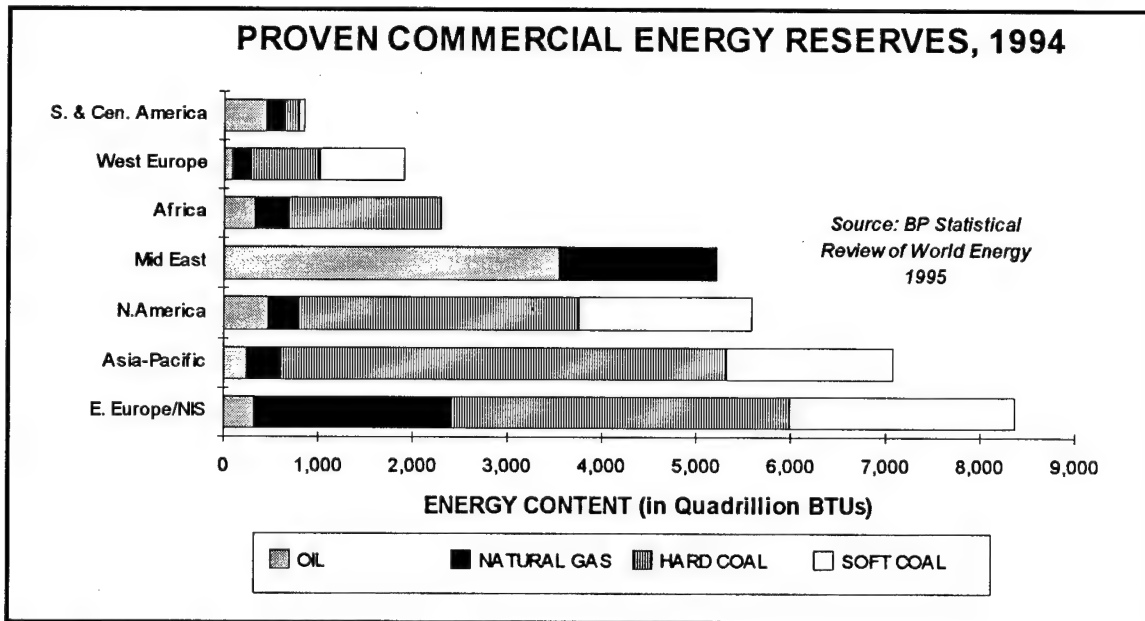
¹³ EIA, *Annual Energy Outlook 1996*, Table A21, December 1995 (www.eia.gov/aeo96).

¹⁴ East-West Center estimate.

¹⁵ British Petroleum, *ibid*; and World Resources Institute, *World Resources 1994-95*, 1994.

- Discussions of energy alternatives also often rely on comparisons of the energy or heat content of different resources. Figure 6-C compares the extent of traditional sources of energy in terms of their heat content, measured in British Thermal Units (BTUs). The Asia-Pacific region is well endowed with coal, especially China, Australia, India, and Indonesia.¹⁶

Figure 6-C



Nuclear Energy

The Asia-Pacific region is actively adding nuclear capacity.¹⁷ China, India, Japan, North Korea, South Korea, Pakistan, and Taiwan have plans to expand current nuclear power programs, and Indonesia anticipates its first nuclear power plant within ten years. With rising demand for electricity, Asian countries pursue the nuclear option primarily because the preference for nuclear power's relative self-sufficiency outweighs cost factors.

- Nuclear power generation capacity will grow during the 1990s, as new plants currently under construction or firmly planned come on line. However, political and environmental concerns will limit any strong growth of nuclear power in the region, and nuclear power's share of Asia's rising demand for power generation may decline.
- The countries most experienced with nuclear power have few indigenous sources of power or have resources that are difficult to harness. High nuclear power capacities are found in Japan (42K megawatts in 1996), South Korea (10K megawatts), and Taiwan (5K megawatts). These countries currently produce about one-third of their electricity

¹⁶ British Petroleum, *ibid.*

¹⁷ Hagen, Ronald E., *The Current Status of Nuclear Power in the Asia-Pacific Region*, East-West Center Energy Advisory Number 174, March 15, 1996, and *Nuclear Energy Thrives in Asia*, East-West Center AsiaPacific Issues, Number 26, November 1995.

requirements from nuclear power, and consequently have accepted the risks of safety and high energy costs.

- Other, less-experienced countries must overcome problems of weak infrastructure, high cost, and inefficient nuclear power plant management. These countries include India (3K megawatts), China (2K megawatts), Pakistan (139 megawatts), and North Korea (240 megawatts). India's most publicized nuclear accident took place in Uttar Pradesh in 1993, when all four safety systems were damaged, but no loss of life occurred.
- Some of Asia's developing countries—Thailand, Indonesia, the Philippines, Vietnam, and Bangladesh—have plans for nuclear power development. However, initial experiences have shown that these high-budget projects are difficult to implement.
- The Korean Peninsula Energy Development Organization (KEDO), an outgrowth of a 1995 U.S. - North Korea agreement, seeks to provide North Korea with benign, light-water nuclear reactors as well as an interim supply of 500,000 metric tons of heavy fuel oil per year.¹⁸ North Korea's energy and security needs illustrate the complex interaction of energy policy with political, military, and economic factors.

Environmental Impact of Energy Demand

Hydro-electric sources of energy also are contentious. Their establishment typically has severe relocation impacts on populations and the environment, and are a source of conflict between local and central governments. China's planned Three Gorges Dam project will lead to the resettlement of 1.2 million people in order to create a system of rural dams and facilities that generate power for people and markets hundreds of miles away.¹⁹

Increased use of oil and coal can lead to higher air pollution and the buildup of greenhouse gases if they are ineffectively processed. China, the world's leading producer and consumer of coal, relies on coal for 76% of its primary energy needs, and contributes heavily to air pollution.²⁰ Clean coal technologies can add 15 to 30% to the capital cost of power plants in Asia, and are a disincentive to governments seeking fast economic growth.²¹ Nevertheless, the cross-border effects of air pollution and the global consequences of the greenhouse effect mean that Asian countries, especially China, will be the focus of energy and environmental concerns.²²

- Developing Asia's share of worldwide carbon emissions is expected to grow from 23% in 1995 to about 33% in 2015; China's share alone will grow from 13% to 19% over the same period.²³
- Addressing Asia's environmental problems represents a growth opportunity for American companies, which have broad-based experience in environmental technologies.

¹⁸ Bosworth, Stephen W., Executive Director of KEDO, Speech, Washington D.C., March 1, 1996.

¹⁹ EIA, *Country Analysis Briefs 1995* (www.eia.gov/emeu/cabs/china.html).

²⁰ British Petroleum, *ibid*.

²¹ Fesharaki, Fereidun, "Asia-Pacific Energy Needs Raise Environmental Questions," *Washington Times*, May 12, 1995.

²² Smil, Vaclav, *Environmental Problems in China: Estimates of Economic Costs*, East-West Center, April 1996.

²³ EIA, *International Energy Outlook 1996*, Table A8, May 1996 (www.eia.gov/oiia/ieo96/tbl08.gif).

Importance of Asia's Energy Demand

Asia's need to address its energy problems cuts across the conventional boundary between economics and security. Increased energy demand, the vulnerability of energy supply routes, and the conflicting claims to offshore areas that may be rich in oil and gas place Asia's energy problems as a foremost concern of both developing and industrialized economies. Kent Calder of Princeton University observes the need for positive approaches to these problems:

"Asia's energy realities cannot be reduced to a purely economic calculus. They have presently subtle but ultimately dangerous implications that should make them a priority in the Pacific policy dialogue now underway. It is profoundly in America's interest to assure, through activism, that energy becomes a bridge for cooperation between the United States, Japan, and the potentially volatile continent of Asia, rather than as a catalyst for distrust and uncertainty.²⁴

²⁴ Calder, Kent, "Asia's Empty Tank," *Foreign Affairs*, March/April 1996.

CHAPTER 7

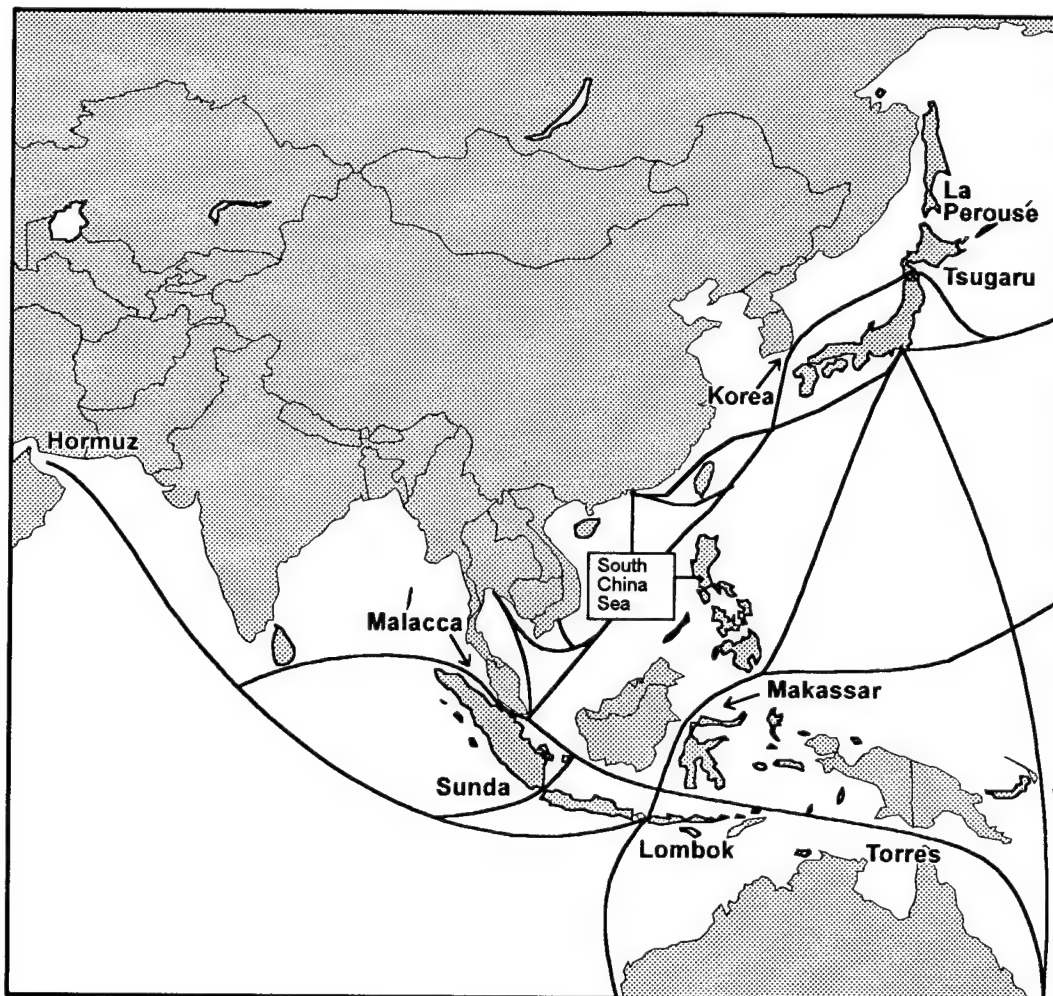
SHIPPING AND COMMERCE

The dynamism of the Asian economies is highly dependent on free passage along the shipping routes of the Asia-Pacific, especially through the shipping straits of Southeast Asia. Dramatic expansion in the volume of commerce flowing into and out of the Asia-Pacific region has sharply raised the security value of Asia's shipping lanes not only to Asian countries, but to the United States as well. This chapter describes shipping routes, commodity flows, shipping facilities and fleets, and discusses related issues, including the U.S. merchant marine industry, piracy in the Asia-Pacific, and tensions over claims in the South China Sea.

Asian Shipping Routes and Commodity Flows

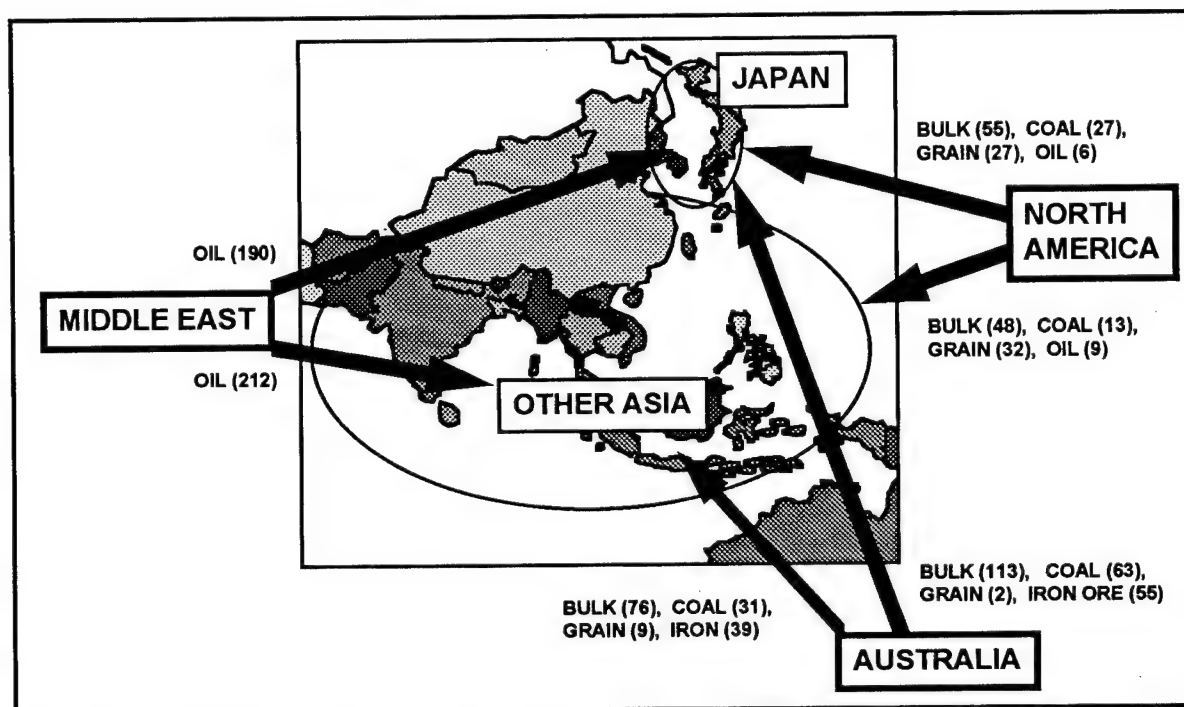
Shipping in the Asia-Pacific region is characterized by long-distance, open-ocean transit combined with dense traffic movement through straits and along coastlines. Figure 7-A shows major maritime trade routes linking the trading economies of the region to the rest of the world.

Figure 7-A
Major Trade Routes and Straits



Cargo flowing into Asia typically includes dry bulk goods, grain, coal, and iron ore from North America and Australia, as well as oil from the Middle East. [Figure 7-B.] Outgoing cargoes consist primarily of dry bulk goods.¹

Figure 7-B
Major Commodity Flows to Asia (1993)
in Million Metric Tons



Sources: Fearnley's and OECD

Major routes are constricted at several key straits, the most important of which are located in Southeast Asia: the Malacca, Sunda, Lombok, and Makassar straits.² The Malacca Strait sees upwards of 60,000 vessels flowing in both directions each year, and is expected to annually serve about 100,000 transits by the year 2000.³ The Sunda and Lombok-Makassar straits are superior to the Malacca Strait in terms of depth and width, but less accessible and possess inferior navigational aids in comparison to Malacca.⁴ These straits cross the waters of Malaysia, Indonesia, and Singapore, the latter having major refueling and transshipment facilities. The waters of the South China Sea (SCS) also comprise a sea line of communication (SLOC), where traffic occurs primarily along the periphery, due to the extensive shallowness of the Spratly Islands in the central part of the SCS.

¹ Fearnley's, "World Seaborne Trade" (<http://cybercomm.no/NR/ki4/3e.html>); Organization for Economic Cooperation and Development (OECD), *Maritime Transport 1994*, Tables 3,6,7, and 9, July 1996; and OECD, "Annual Report: Maritime Transport 1994" (www.oecd.org/transport/mtc/mtc15.html).

² Bordeaux, Christopher, "Strategic Shipping Lanes," *Petroleum Supply Monthly*, Energy Information Administration, Jan. 1994; and Feld, Lowell, "World Oil Chokepoints," (www.eia.doe.gov/emeu/cabs/choke.html).

³ Abdullah, Ym Raja Jalil, "Alternative Routes - Bulk, Oil and Container Trade: Comparative Vessels Costs," *Proceedings of the Kuala Lumpur Workshop on the Strait of Malacca*, Malaysian Institute of Maritime Affairs, January 1994.

⁴ Abdullah, *ibid*.

- The Malacca Straits witnessed 114 inter-regional large ships on a daily basis in 1993. These crowded, shallow, and narrow straits are a concern for maritime safety. Over 1,100 fully laden supertankers pass eastbound through the straits each year, many with only a meter or two of clearance between their keels and the channel bottom.⁵
- Half the shipping volume passing the Spratly Islands is crude oil from the Arabian Gulf.
- Australian-origin dry bulk accounts for most of the tonnage in the Lombok Straits.

Generally, crude oil is the biggest single cargo in terms of volume through the SLOCs of Southeast Asia, while industrial products are the dominating cargo in terms of value. The overall pattern of shipping is that large tonnages of low-value commodities are shipped to industrial economies (Japan and the Four NIEs), which then "add value" via manufacturing processes. The industrial economies then ship out relatively smaller tonnages of high-value goods. Figure 7-C identifies the volume (in million metric tons, or MMTs) and the value of trade moving through the SLOCs of Southeast Asia in 1993.

Figure 7-C
Trade Flows through Southeast Asian SLOCs

SLOC	Tonnage (MMTs)	Value (\$B)
South China Sea	580	470
Malacca	525	390
Sunda	15	5
Lombok	140	40

Source: CNA

About 15% of the total value of world trade transits the Southeast Asian SLOCs. The value of two-way trade transiting these SLOCs is high not only for Japan (\$256B in 1993), but also for Europe (\$269B), the NIEs of Hong Kong, Taiwan, and South Korea (\$163B), the United States (\$43B), and China (\$30B). The economies of Southeast Asia, Japan, and Australia are highly dependent on these straits for their trade. The SLOCs of Southeast Asia handle 54% of the total two-way trade of Southeast Asian countries, 42% of Japan's trade and 46% of Australia's trade. Many countries of Southeast Asia are either peninsular or insular, having extensive coastlines. Land transport structure is not well developed, and most Southeast Asian trade moves by sea. Thus geographic and economic factors confer considerable importance to these key waterways.

Most of the ships transiting these SLOCs are "flagged out" to countries such as Panama and Liberia, but are owned by other countries, primarily Japan. In 1993, Japan owned 432 Million Dry-Weight Tonnes (MDWT) of the fleet capacity transiting the Malacca Straits, followed by Greece (102 MDWT), the United States (97 MDWT), Great Britain (90 MDWT), and Singapore (88 MDWT).

⁵ Noer, John, and David Gregory, *Maritime Interests and the Sea Lines of Communication Through the South China Sea: The Value of Trade in Southeast Asia*, Center for Naval Analyses, January 1996. Subsequent references to SLOC data are from this source.

Shipping Facilities

High trade volumes have led to a significant growth in shipping facilities throughout the Asia-Pacific region.

- Hong Kong and Singapore rival each other as the world's largest container ports. In 1995, Hong Kong processed 12.6M twenty-foot equivalent units (TEUs),⁶ while Singapore handled 11.8M TEUs.⁷ Taiwan's Kaohsiung became the world's third largest container port in 1994, processing 5.1M TEUs in 1995.
- Demand is outpacing the region's shipping infrastructure. Ports are being expanded in Laem Chabang in Thailand; Bombay, India; Ho Chi Minh City and Cua Lo in Vietnam, Penang and Klang in Malaysia; Indonesia's Batam Island near Singapore; Subic Bay in the Philippines; and at ports along coastal China.⁸ Currently, only 25% of China's shipping goes via modern container systems, in contrast to Hong Kong, where 90% is containerized.⁹

Merchant Fleets

Asia-Pacific economies own a significant share of world shipping. Asian countries as a whole own 31% - and manufacture 74% - of the world's merchant fleet tonnage.

- Japan controlled 13% of world merchant fleet tonnage in 1994, following Greece's 17% share. The United States was third largest, controlling 11%, followed by Norway (7%), and China (5%). The four Newly Industrialized Economies (Hong Kong, Singapore, Taiwan, and Korea) rival U.S. ownership, owning 11% as a group.¹⁰
- In 1994, the share of the world's shipbuilding tonnage was high for Japan (45.5%), Korea (21.5%), and other Asian countries (7%).¹¹
- The Maritime Security Program, currently under congressional discussion, seeks to preserve a modern U.S. merchant fleet whose ships could also provide military sealift capacity during periods of national emergency. The act levies additional port fees to encourage the use of U.S. merchant ships for both commercial and military purposes.
- As part of its "Shipyard Revitalization Plan," the Administration is also supporting the multilateral "OECD Shipbuilding Agreement," which seeks to eliminate unfair foreign subsidies and other trade-distorting practices, providing more equal terms for competition in the global commercial shipbuilding market.¹²

⁶ The TEU measure, based on a container length of twenty-feet, is a basic unit for expressing the capacity for carrying containers upon vessels that are fully cellular, part-container, or roll-on/roll-off.

⁷ Port of Singapore Authority in *Business Day (Bangkok)*, January 19, 1996.

⁸ Far Eastern Economic Review, *Asia Yearbook*, (series).

⁹ Zubrod, Justin, *et al*, "The Challenges of Logistics in Asia," *Transportation and Distribution*, February 1996.

¹⁰ Institute of Shipping Economics (ISL), *ISL Shipping Statistics and Market Review*, April 1995.

¹¹ Far Eastern Economic Review, *Asia Yearbook 1996*, December 1995.

¹² Hillman, Jennifer, Office of USTR, Testimony to House Special Oversight Panel on the Merchant Marine, May 22, 1996.

Maritime Piracy

Commercial shipping is still vulnerable to acts of piracy in the Asia-Pacific region. Of the world's 100 reported cases in 1995, 60 occurred in Asian waters (25 in Indonesia, where most incidents occurred in-port).¹³ Major threat locations are in the Southeast Asian straits and the northern South China Sea. The threat to shipping has expanded in 1996 to the area north of Indonesia's Natuna Island, which is located in the South China Sea near the waters of Vietnam, the Philippines, and Malaysia and is difficult to control.¹⁴ To combat piracy Indonesian and Singaporean authorities have increased their cooperation, and the commercially-funded International Maritime Bureau (IMB) Piracy Center was established in Kuala Lumpur under the International Chamber of Commerce's Commercial Crime Services Division. Attacks and thefts in-port are also common. A recent trend in Asian piracy is the theft of entire cargoes through falsely documented ships.¹⁵

Maritime piracy incidents, although now at moderate levels, present a potential threat to commercial shipping.¹⁶ Multilateral efforts, such as coordination with the activities of the International Maritime Bureau, are being promoted to stem further challenges to international economic security. Piracy may also be an appropriate agenda item for such organizations as the ASEAN Regional Forum (ARF) and the Asia Pacific Economic Cooperation (APEC).

Tension over Claims in the South China Sea

The existence of unresolved claims of sovereignty over islands and reefs that lie alongside major shipping lanes in the South China Sea has been a source of potential instability to the area.¹⁷ The Philippines, Vietnam, Malaysia, China, and Taiwan have made sovereignty claims to all or part of the Spratly Islands. Brunei has made maritime claims extending into the disputed area. Both China and Taiwan have made imprecise claims covering most of the SCS, while official statements refer to island groups in name only. A seventh country, Indonesia, also possesses significant oil and gas potential in the nearby Natuna Island area.¹⁸

- In 1992, ASEAN member countries issued the "ASEAN Declaration on the South China Sea", which called on all parties to "resolve all sovereignty and jurisdictional issues pertaining to the South China Sea by peaceful means." The Declaration also urged all parties to exercise restraint and to cooperate on maritime safety, pollution, search and rescue, and combating piracy and drug trafficking. The United States and China subsequently made statements of support for the ASEAN Declaration.
- Tensions increased in early 1995 when China established facilities at Mischief Reef in the Spratly Islands. China denied they were military facilities, but were fishing facilities, although the Philippines had declared an encompassing 200 nautical mile Exclusive

¹³ Far Eastern Economic Review, *Asia 1996 Yearbook*, December 1995.

¹⁴ Office of Naval Intelligence, *World-Wide Threat to Shipping* (series).

¹⁵ Marine Watch Institute, "Phantom Ships: Piracy's Newest Twist in Asia" (<http://www.marinewatch.com/piracy.html>).

¹⁶ Kenny, Henry J., *An Analysis of Possible Threats to Shipping in Key Southeast Asian Sea Lanes*, Center for Naval Analyses Occasional Paper, February 1996.

¹⁷ Kenny, Henry J., *The South China Sea: A Dangerous Ground*, Naval War College Review, Summer 1996.

¹⁸ USCINCPAC Research and Analysis Division, *South China Sea Reference Book*, April 1996.

Economic Zone in 1978.¹⁹ The Philippines subsequently removed Chinese claim markers in the area.

- The United States has issued statements advocating freedom of navigation, peaceful measures to resolve differences, and the use of international law, especially the 1992 United Nations Convention on the Law of the Sea,²⁰ which, with the exception of Taiwan, the six claimants have signed. The United States has taken no position on the legal merits of competing sovereignty claims and supports peaceful resolution of claims and peaceful development of resources. In addition to its direct need for freedom of navigation through the SCS, U.S. interests include an open economic region that adheres to principles of international law. Openness is promoted by the lack of any dominant power that may threaten regional stability and growth. Regional economic development is enhanced by the maintenance of international trade through the free flow of shipping. Regional stability and growth are reinforced by peaceful settlement of disputes and a preference for the rule of law. The threat or use of military force would be seen as disrupting regional peace, prosperity and security.

¹⁹ U.S. Department of State, Bureau of Oceans and International Environmental and Scientific Affairs, *Limits in the Seas Number 36: National Claims to Maritime Jurisdiction*, January 11, 1995.

²⁰ Department of Defense, *National Security and the Convention on the Law of the Sea*, July 1994.

CHAPTER 8 DEFENSE SPENDING AND ARMS TRADE

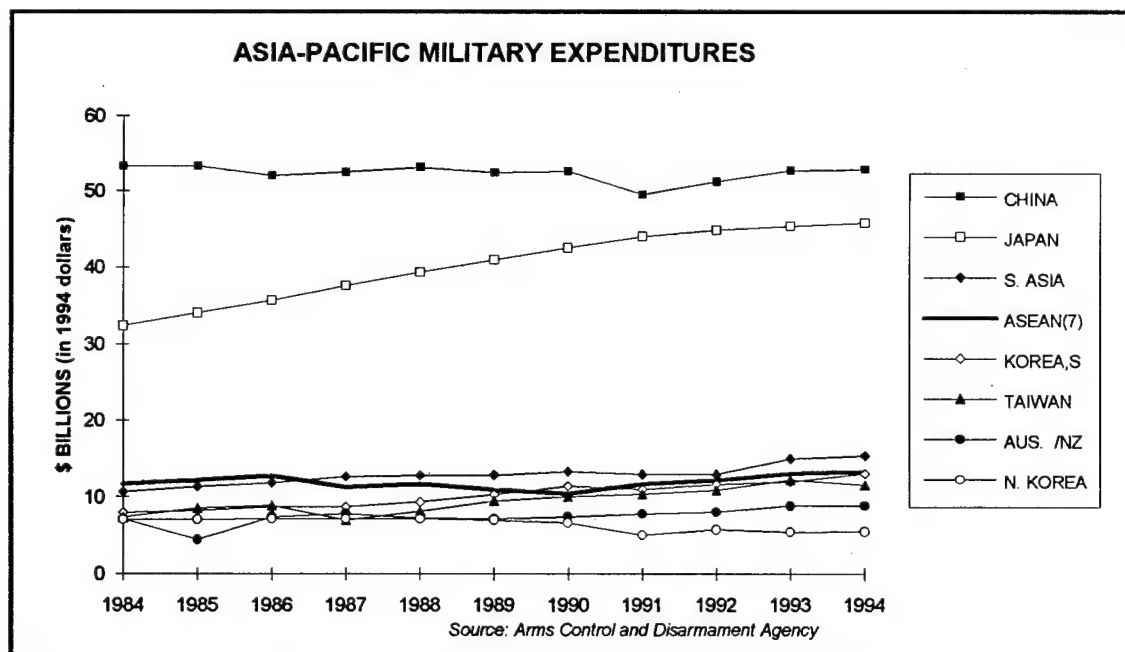
Increased defense spending and military modernization by many nations have accompanied dramatic economic growth in the Asia-Pacific region. This chapter examines Asia's military spending trends and the arms trade. There is no arms race in Asia at the present time, but the People's Republic of China and several other nations are modernizing their forces. Thus, there is a continuing need for prudence in arms sales, increased transparency, expanded security dialogue, and American military engagement in the region to discourage any disproportionate buildup. This perspective is consistent with the *United States Security Strategy for the East Asia-Pacific Region*¹ and the Presidential Decision Directive, *Conventional Arms Transfer*.²

Asia-Pacific Spending Trends

Eight of the world's nine largest armed forces are located in or operate in the Asia-Pacific region.³ China has the world's largest army (2.9M troops), followed by the United States (1.7M) and Russia (1.4M). Five of the next six largest military forces are Asian countries: India (1.3M), North Korea (1.2M), Vietnam (0.9M), South Korea (0.75M), and Pakistan (0.5M).

Many Asian governments have embarked on programs of arms procurement and military modernization over the last decade. However, in absolute terms, defense expenditures in the Asia-Pacific region have been stable or increasing at a moderate pace.⁴ (See Figure 8-A and Appendix C, Table 5.)

Figure 8-A



¹ Department of Defense, Office of International Security Affairs, *United States Security Strategy for the East Asia-Pacific Region*, February 1995.

² Office of the President, *Presidential Decision Directive - 34 on "Conventional Arms Transfer"*, February 17, 1995.

³ U.S. Arms Control and Disarmament Agency (ACDA), *World Military Expenditures and Arms Transfers (WMEAT) 1995*, Table I, April 1996, (www.acda.gov/wmeat95/tab1idx.htm). Turkey is ranked seventh with 0.8M troops.

⁴ ACDA, *World Military Expenditures and Arms Transfers 1995*, Table I, April 1996, (www.acda.gov/wmeat95/tab1idx.htm).

In comparison to the rest of the world, Asia-Pacific defense expenditures exceed those of the Middle East and other developing regions, and almost match spending in Western Europe. However, Asia-Pacific countries generally spend less on defense on a percent-of-GDP basis than the world average. With continued economic growth in the Asia-Pacific region, its economies are expected to continue to increase absolute spending on defense.

- Over the ten year period between 1984 and 1994, overall defense spending in the region grew 21% after correcting for inflation. During that same time period, defense spending in the United States decreased, while spending in Western Europe declined moderately.
 - Asian countries with long-term real growth in defense expenditures over the period from 1984 to 1994 have been South Korea (5% annual increase), the Philippines (7%), Singapore (5%), Pakistan (4%), Malaysia (5%), and Japan (4%).
 - In contrast to the rise in absolute spending, the share of military spending in Gross Domestic Product (GDP) has been declining in the Asia-Pacific region, as is the case for the world average since 1986. Military spending as a percent of GDP is expected to continue to decline in the near future for all regions of the world, including Asia.⁵
- Northeast Asia, including China, Japan, North and South Korea, and Taiwan, has the highest level of military expenditures in the Asia-Pacific.
 - China's defense spending is by no means transparent.⁶ The official Chinese defense budget for 1994 was estimated at \$7.5B; however, Chinese estimates do not follow common accounting methods. The International Institute for Strategic Studies' (IISS) figure is almost four times (\$28.5B),⁷ while the U.S. Arms Control and Disarmament Agency (ACDA) estimate (\$52.8B) is seven times the Chinese figure.⁸ RAND Corporation offers significantly higher estimates. Therefore, according to some estimates, China is the biggest spender on defense in the region.
 - Japan has the second highest level of defense spending in the region, even though it is politically constrained to maintaining its defense spending at no higher than 1% of GDP. Japan has shown a steady growth in real defense expenditures over time, experiencing 42% growth between 1984 and 1994, after accounting for inflation.
 - North Korea, with the fifth largest army in the world, is an unusual case, with extremely high defense spending in comparison to its overall economic production. North Korea devotes 26% of its GDP to the military sector. Such high levels of spending create internal economic and social pressures that further distress North Korea and the region.

⁵ International Monetary Fund, *World Economic Outlook*, October 1993.

⁶ Chanda, Nayan, "Fear of the Dragon," *Far Eastern Economic Review*, April 13, 1995.

⁷ International Institute for Strategic Studies (IISS), *The Military Balance 1995/96*, October 1995, (www.isn.ethz.ch/iiiss/).

⁸ ACDA, *World Military Expenditures and Arms Transfers 1995*, Table I, April 1996, (www.acda.gov/wmeat95/tab1idx.htm).

- South Asia, which spent \$15B on defense in 1994, is the seat of significant ethnic and religious rivalry. South Asian countries spend high levels on defense relative to their trade figures. India and Pakistan increased their spending between 1992 and 1994 by 12% and 19.5%, respectively.⁹
- Southeast Asia spent \$10B in 1994 on defense. Spending patterns may change as tensions subside after the assimilation of Vietnam into ASEAN in 1995. However, new tensions have been created over increased military activities in the South China Sea.¹⁰
 - Vietnam, with the sixth largest army in the world, saw a significant decrease in defense expenditures (-20%) over the period 1984-1994. Vietnam's defense share of GDP has declined from 19.4% in 1986 to 2.2% in 1994, making its defense spending comparable to other countries in Southeast Asia.

Motives for Defense Spending and Arms Acquisition

Defense analysts have identified several factors that have contributed to an increase in regional defense spending. These can be organized into demand-side and supply-side pressures.

- Demand-side factors include: economic growth and availability of resources for defense; pursuit of increased prestige and international recognition; uncertainty over the future of U.S. military presence in the region; enhancing conventional self-defense capabilities; potential rise of competing regional powers; increased likelihood of conflict from regional tensions (territorial disputes, competing sovereignty claims, challenges to government legitimacy, and historical animosity); surveillance and protection of Exclusive Economic Zones (EEZs); economic issues (protection of sea lanes, marine resources, and fishing stocks), and environmental issues (pollution, deforestation, and oil spills).
- Supply pressures include: the large supply of surplus equipment as a result of the downsizing of western forces; selling equipment for hard, foreign currency; and promoting interoperability of military forces for coalition humanitarian and combat operations.

The primary objectives of defense acquisitions in the Asia-Pacific region appear to be modernization of military forces, adaptation to new requirements for naval and air defense, and procurement of high-tech equipment. Acquisition programs generally emphasize command, control, and communications (C³) systems; strategic and tactical intelligence systems; multi-role fighter aircraft; modern surface combatants and submarines; anti-ship missiles; electronic warfare (EW) systems; and rapid deployment forces. Appendix C, Table 6, identifies recent, important arms imports in the Asia-Pacific region.

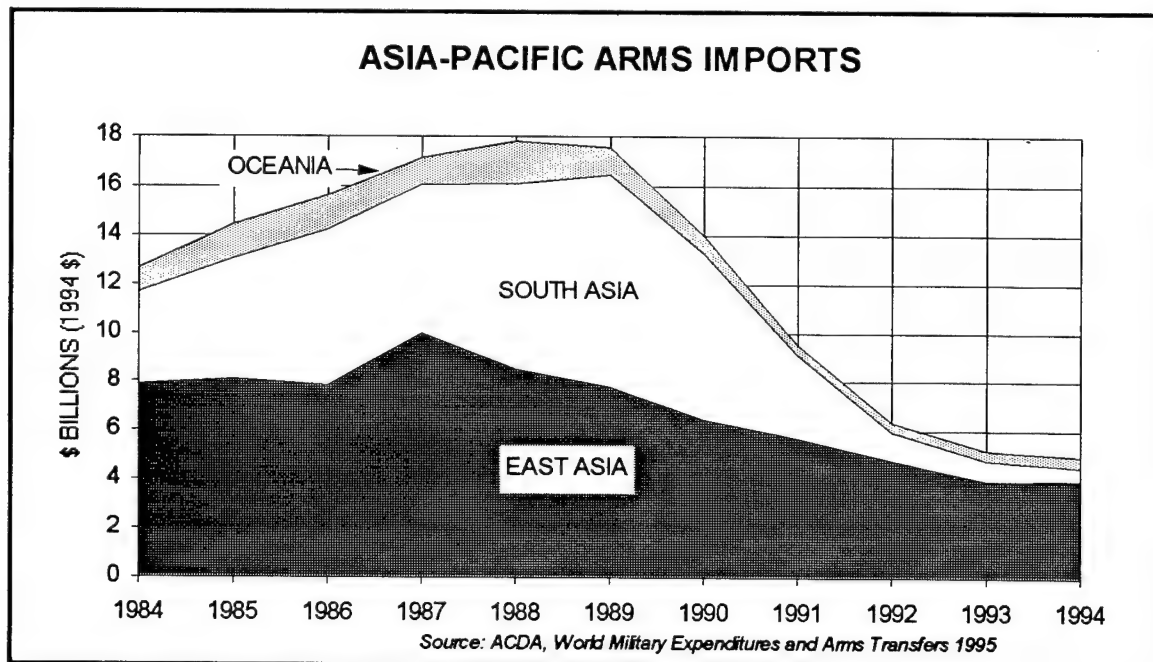
⁹ Stockholm International Peace Research Institute (SIPRI), *SIPRI Yearbook 1995: Armaments, Disarmament and International Security*, September 1995, (www.sipri.se/pubs/yb95/yb95in.html).

¹⁰ IISS, *The Military Balance 1995/96*, October 1995.

Asian Arms Trade

Asia's large force requirements at the turn of the decade led the region to become an important source of demand for military equipment in the declining global arms market. The Asia-Pacific region's share of world expenditure on arms imports increased from 15% in 1984 to 28% in 1989. The share subsequently declined to 18% in 1993, but climbed to 22% in 1994 due to a relatively faster decline in other parts of the world. The total value of Asian arms imports declined from a peak of \$17.5B in 1988 to \$5.0B in 1994, 28% of the peak year value.¹¹ (See Figure 8-B.)

Figure 8-B



- East Asia was the world's third largest arms market during 1991-1994, despite declining arms imports. The distribution of arms imports among East Asian countries also changed during this Post-Cold War period. Those countries which dramatically reduced imports during this period include Japan, and, primarily due to a drop-off of support from Russia, Vietnam, North Korea, and Cambodia. China saw a peak year of imports in 1992 of over \$1.2B, but then dropped dramatically to \$130M by 1994. Major Asian arms importers in 1994 were South Korea (\$1.0B), Taiwan (\$775M), and Japan (\$650M).
- South Asia saw a dramatic decline in arms imports from a peak of \$8.7B in 1989 to \$540M in 1994. Both India and Afghanistan reduced purchases in the late 1980s. In terms of the world's leading arms importers during 1994, Pakistan ranked 18th (or \$260M) and India 28th (or \$140M).

¹¹ ACDA, *World Military Expenditures and Arms Transfers 1995*, Table II, April 1996, (www.acda.gov/wmeat95/tab2idx.htm). (All ACDA values quoted here are in 1994 dollars)

- In future years, the Asia-Pacific region's share of global arms imports is expected to be high. Over the period 1994 to 2000, East Asia's share of global arms imports is expected to reach 30%, while South Asia may receive 5% and Oceania 4% of arms imports.¹²

After the breakup of the Soviet Union, the United States became the dominant supplier of arms to the world, providing one-half of the total in 1992-1994. Since 1989, the United States has been the dominant supplier to East Asia, while Russia and China are the primary suppliers of arms to South Asia. (See Appendix C, Table 6, for recent examples of key Asian arms imports and their suppliers.)

- The U.S. share of arms sales to East Asia increased from 44% in the five year period 1985-1989, to 58% during 1990-1994. Meanwhile, the Russian/USSR share declined from 40% to 18% over the same two periods.¹³ Russian arms sales increased dramatically from \$3.7B in 1994 to \$6B in 1995, primarily due to arms sales to China.¹⁴
- Despite an increasing share of the East Asian arms market, U.S. arms transfers to East Asia declined from a peak value of \$3.6B in 1990 to \$2.3B in 1994.
- South Asia's arms market has been dominated by Russia/USSR, which had 72% of the market during 1984-1994. However, total South Asian arms imports have dried up to where 1994 imports were less than \$0.5B.
- China's arms exports amounted to only 4% of the world total during 1992-1994. Major recipients then were Pakistan (\$875M), Iran (\$525M), and Burma (\$300).¹⁵ China's weapons sales remain controversial.¹⁶ It is unique in that most arms exporters are industrialized countries, while China is still classified as a developing country. Further, China has been accused of not adhering to proliferation pledges under the Missile Technology Control Regime, although China disputes the charge. The reported sale of missiles to Iran and Pakistan, along with low-tech arms to Burma, have been widely criticized in the press and by arms experts.
- North Korea's arms exports peaked in 1988 with sales of \$850M; however, sales totaled only \$30M by 1994.¹⁷

Conclusion

Recent descriptions of defense spending in the Asia-Pacific region have characterized the situation as either a dangerous arms race or as the benign pursuit of weapons modernization. Neither extreme seems to capture the complex nature of Asia's arms market, which is influenced by a broad range of supply and demand factors. Accordingly, several measures are being pursued to prevent the region's acquisition programs from evolving into an arms race.

¹² Department of Defense, *World-Wide Conventional Arms Trade (1994-2000): A Forecast and Analysis*, December 1994.

¹³ ACDA, *World Military Expenditures and Arms Transfers 1995*, Table IV, April 1996. (www.acda.gov/wmeat95/tab4idx.htm).

¹⁴ Grimmett, Richard, *Conventional Arms Transfers to the Third World*, Congressional Research Service, August 1996.

¹⁵ ACDA, *World Military Expenditures and Arms Transfers 1995*, April 1996.

¹⁶ Far Eastern Economic Review, *Asia 1996 Yearbook*.

¹⁷ ACDA, *World Military Expenditures and Arms Transfers 1995*, Table II, April 1996, (www.acda.gov/wmeat95/tab2idx.htm).

- Prudence in arms sales and technology transfer to enhance regional stability and U.S. security interests. In February 1995, President Clinton approved a comprehensive policy to govern transfers of conventional arms.¹⁸ This policy promotes restraint, both by the U.S. and other suppliers, in weapons transfers that may be destabilizing or dangerous to international peace. At the same time, the policy supports transfers that meet legitimate defense requirements of our friends and allies, in support of our national security and foreign policy interests. A 1996 report by the Presidential Advisory Board on Arms Proliferation recommends measures for increased restraint and control of arms transfers.¹⁹
 - Effective restraint requires international cooperation together with U.S. leadership.
 - New international export control policies are needed for a technology market where there are numerous channels of supply and where many advanced technologies relevant to weapons development are commercial in origin.
 - U.S. arms transfer policy can and should be developed and executed separate from policies for maintenance of the defense industrial base.
 - Arms and weapons technology transfers should take place without the price-distorting mechanism of government subsidies or penalties.
- Expanded opportunities for multilateral security dialogue, at both the official level and the non-government level. Two organizations provide such opportunity: the ASEAN Regional Forum (ARF), established at the ASEAN post-Ministerial Conference in July 1993; and the Council for Security Cooperation in the Asia-Pacific (CSCAP), a non-governmental organization (NGO) that promotes regional confidence building and security cooperation. (See Appendix A.)
- Increased transparency among nations of the region about military capability, intentions, and arms transfers. These types of confidence building measures are being discussed at the ARF. There are ongoing efforts through ARF to seek publication of official white papers by the region's governments and the establishment of a public registry that contains general information on arms acquisitions.
- Increased military-to-military contact with nations in the Asia-Pacific region. The further development of military-to-military relationships between the United States and nations in the region is prudent for several reasons: it helps to establish trust and rapport; enables a freer flow of information between the nations; and it contributes understanding and appreciation of military intentions and capabilities. The U.S. International Military Education and Training (IMET) program helps foster this approach.
- Finally, and most importantly, continued American leadership and military engagement in the region to discourage any disproportional buildup.

¹⁸ White House Fact Sheet, "Conventional Arms Transfer Policy," February 17, 1995.

¹⁹ Nolan, Janne, (Chair), *Report of the Presidential Advisory Board on Arms Proliferation Policy*, 1996.

SECTION IV

SPECIAL TOPIC

"How China defines itself and its greatness as a nation in the future, and how our relationship with China evolves will have as great an impact on the lives of our own people and, indeed, on global peace and security, as that of any other relationship we have."

*President William Clinton
Remarks to the 29th International Meeting of
the Pacific Basin Economic Council
20 May 1996*

"Greater China is the fastest growing and most dynamic economic region in the world. China has used foreign investments and export-led growth to achieve annual growth rates of 9 percent in real terms over the last 15 years, creating a natural economic territory that crosses political borders and incorporates Hong Kong and Taiwan."

*"Redressing the Balance: American Engagement with Asia," Asia Project Policy Report, 1996
Council on Foreign Relations*

CHAPTER 9

THE CHINESE ECONOMIC AREA

Introduction

With 1.2B people, the People's Republic of China (PRC) is the world's most populous country. It is the second largest economy in the world, measured on a purchasing power parity (PPP) basis, according to the World Bank and the CIA. This region achieves even greater economic significance when the PRC, Hong Kong, and Taiwan, the area collectively referred to as the Chinese Economic Area (CEA) for analytical purposes, are examined as a unit. The economic activity within this area, as well as the economic activity between this area and the world, is rapidly growing. This increased economic activity translates into increased political importance. In fact, the stability of the CEA is essential to the maintenance of peace and prosperity in the Asia-Pacific region.

However, unlike other economic areas, such as the European Union or North American Free Trade Agreement (NAFTA), the CEA is not comprised of mutually recognized independent states. Conflicting claims regarding political rights have created great tension in this area. Additionally, the uncertainty regarding succession of power in the PRC has added to tensions and increased the potential for political instability in the area, as well as in the Asia-Pacific region. Analysts perceive that increasing economic interdependence will play an integral role in future political scenarios. The major question concerning the CEA is whether economic cooperation will ultimately outweigh political confrontation.

PRC-Taiwan Relations

Taiwan and the PRC are important economic partners. Despite their official lack of mutual, diplomatic recognition, they have been pulled together economically by the complementary nature of their economies. This complementary economic relationship, although significant, is not powerful enough to overcome political tensions between these two economies. There is clear evidence that both sides recognize the importance of maintaining their economic relations. There is also significant evidence that regardless of this economic relationship, the political stakes are far too high for Chinese leaders to allow Taiwan's independence.

Trends and Status of Trade and Investment: Both Direct and Indirect

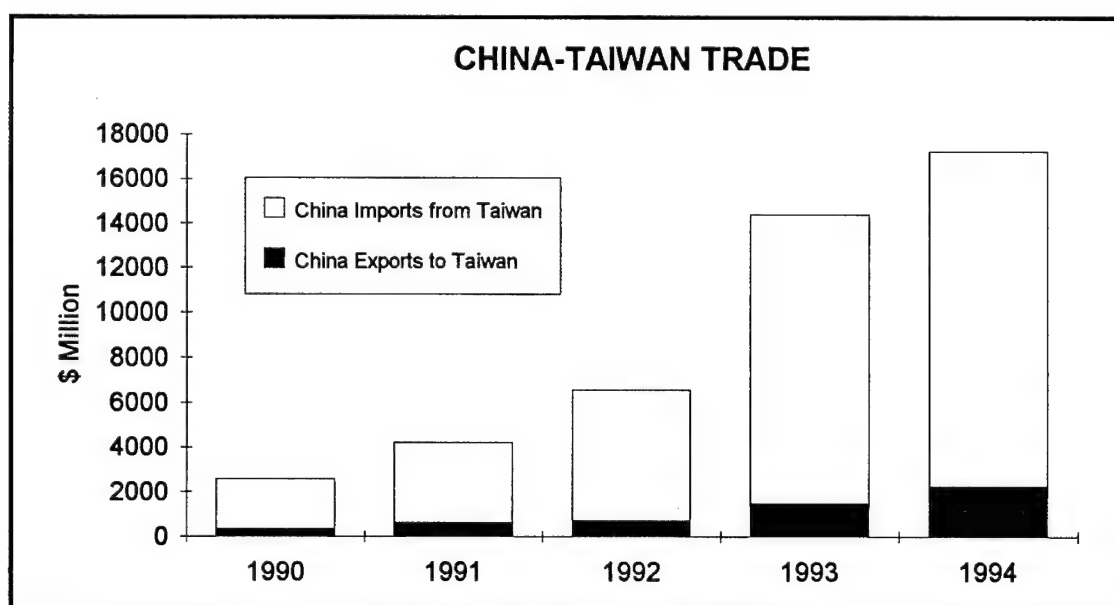
The PRC unilaterally ended its ban on Taiwanese trade and investment in 1979. Taiwan waited until 1985 to reciprocate, when it lifted its ban on indirect trade and investment with the PRC. However, there are several restrictions associated with this trade and investment, including the stipulation that it legally must pass through a third destination, and trade must use a different transport vessel on each leg of transit. In August 1996, the PRC offered to open direct shipping links with Taiwan.

Economic relations have gone through considerable strain in the last year, with President Lee Teng-hui's visit to the United States and PRC military exercises prior to Taiwan elections. With the elections over, the PRC and Taiwan are making conciliatory gestures to ensure that

trade and commerce continue. For instance, Fujian province announced a package including 25 key infrastructure projects over the next five years meant to foster trade with Taiwan.¹

Taiwan and the PRC are drawn together economically by their complementary relationship. The PRC offers Taiwan natural resources and a source of cheap labor, which it needs to stay competitive in the global market. Taiwan, in return, provides the PRC with investment capital, technical achievement, and a high level of "human capital" comprised of Western-trained scientists, engineers, and businessmen. Taiwan's level of technical advancement is illustrated by the fact that in 1994 Taiwan was the world's largest producer of portable computers and the world's fourth largest producer of all computer equipment. As an indicator of the high level of education attained by Taiwanese society, more than half of the government's cabinet members have earned doctorates from American universities.

Figure 9-A



Source: International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1995.

The economies of the PRC and Taiwan are becoming integrated through rapid expansion of trade and investment in the form of indirect trade, mostly in the form of reexports through Hong Kong. The indirect nature of this trade through Hong Kong has led to discrepancies in reported statistics, but the general trends are easily discernible. There is no doubt that the volume of trade between these two economies has been growing rapidly. Figure 9-A shows the rapid increase in two-way trade between the PRC and Taiwan, including that via Hong Kong.

With the lack of direct trade between the PRC and Taiwan, Hong Kong plays an important role as an intermediary. It is estimated that 75% of the official trade between these two economies is channeled through Hong Kong.² Hong Kong has strong economic incentives to ensure that direct trade is not allowed, because direct trade would cost Hong Kong an estimated \$1B annually in lost profit.³

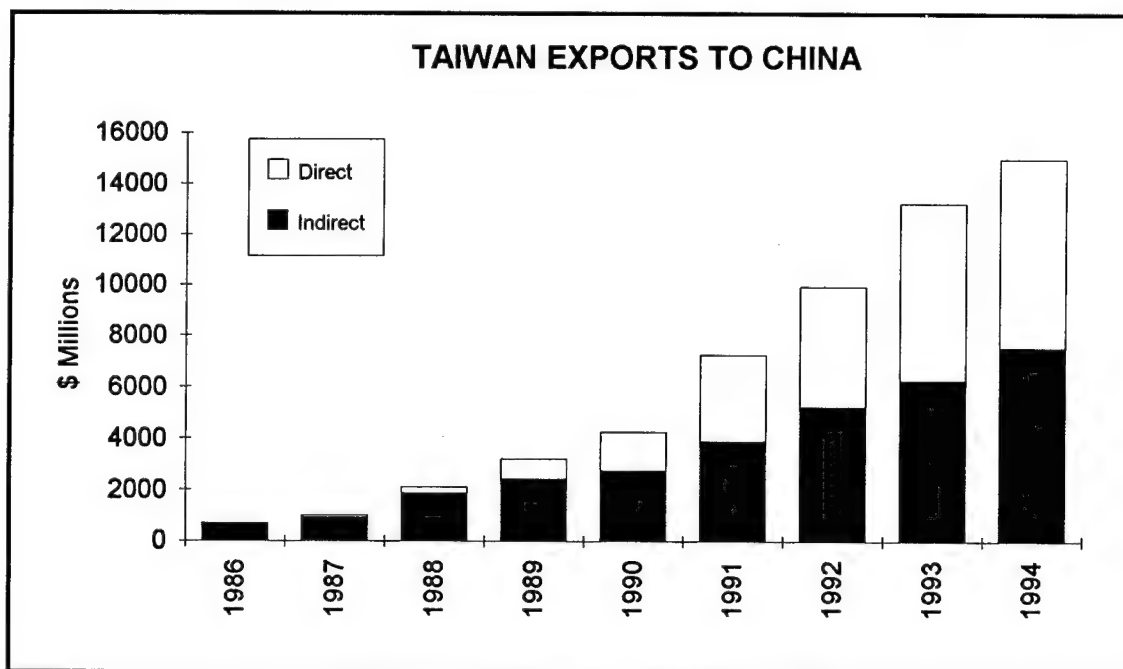
¹ Bangsberg, P.T., "Election Over, Taiwan, China Seek to Normalize Relations," *The Journal of Commerce*, April 12, 1996.

² "Taiwan Officials in Hong Kong Cool About Chinese Drills," *Japan Economic Newswire*, March 12, 1996.

³ Yun-Wing, Sung, "Economic Interdependence in the Natural Economic Territory," *Southern China, Hong Kong, and Taiwan: Evolution of a Subregional Economy*, 1995, pp. 39.

In addition to the indirect trade through Hong Kong, there is substantial direct trade between the PRC and Taiwan, which is illegal based on Taiwan's laws. Estimates of this direct trade can be made by evaluating the difference in Taiwan's export records to Hong Kong versus Hong Kong's import records from Taiwan, with the difference representing trade subverted to direct shipments. Figure 9-B shows that the large rise in exports has been driven largely by a rapid increase in the volume of direct trade.⁴

Figure 9-B



Sources: Yun-Wing, Sung, "Economic Interdependence in the Natural Economic Territory," *Southern China, Hong Kong, and Taiwan: Evolution of a Subregional Economy*, 1995, and International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1995.

Taiwan's imports from the mainland are restricted to selected commodity categories. Prohibited goods from the mainland are illegally imported into Taiwan with fake country-of-origin certificates. This practice makes estimating Taiwan's direct imports from the PRC very difficult. Comparison of transshipment weights is the best tool to estimate this direct trade, but yields very inaccurate estimates of the value of such trade. Since 1992, Hong Kong's records show that reexports of mainland goods to Taiwan have stagnated. However, the PRC's records show that transshipment of mainland goods to Taiwan has continued to soar, suggesting that trade growth is occurring in illegal direct trade from the PRC to Taiwan.⁵

Taiwan is rapidly increasing the amount of imports coming from the PRC. In 1994, Taiwan's imports from the PRC grew 53%, while the PRC's imports from Taiwan grew 9%. However, the PRC still provides a relatively small, 3% of Taiwan's overall imports. Taiwan remains a very important source of the PRC's imports. In 1991, Taiwan became the second largest supplier to the PRC. Hong Kong statistics note that Taiwan transshipments to the PRC of both electrical machinery and textile yarn, fabrics, and apparel were up by nearly one-third. Sales of plastic in primary forms to the mainland increased by almost one-half.

⁴ Yun-Wing, p. 29.

⁵ Yun-Wing, p. 29.

Taiwan investments in the PRC have been rapidly increasing since 1985. Taiwan is the second-largest investor in the mainland after Hong Kong. Because of the indirect nature of much investment, there are large discrepancies between official and private statistics. Official Taiwan statistics report cumulative foreign direct Taiwanese investment in the PRC as \$9.4B as of 1994. However, experts estimate that cumulative Taiwanese investment in the PRC is \$25 to \$30B as of 1996.⁶ Taiwan investment is concentrated in the PRC's southern provinces. It is the largest investor in Fujian Province, with more than half of Fujian's 9,800 joint ventures being solely or partly funded by Taiwanese investors.⁷ However, the primary destination of Taiwanese investment in the PRC is Guangdong, due to its economic strength, investment climate, and superior infrastructure.

While Taiwan plays a major role in the PRC's foreign investment market, the PRC plays an insignificant role in Taiwan. Although the exact amount of investment is unknown, it is recognized that the PRC's cumulative investment in Taiwan is negligible.

Despite the rapid expansion of economic links between Taiwan and the mainland, there are some signs of caution. Taiwanese entrepreneurs are hedging their bets by placing a rising share of their investments outside of the PRC. Seeking to avoid economic dependence upon the mainland, the Taiwanese government has been encouraging investment in Southeast Asia. Taiwan investments in nearby Southeast Asia are approaching the amount of money already committed to the mainland; Taiwan is the largest or second largest foreign investor in Vietnam, the Philippines, Thailand, and Malaysia, and its investment in Indonesia is growing rapidly. The success of Hong Kong's transition will greatly influence the future pattern of Taiwanese investment.⁸

Implications for Future Relationships and Tensions

As the trade and investment stakes between countries increase, the political and economic interests become more and more related. For instance, the tensions from Lee Teng-hui's visit and Taiwan's elections had a clear economic impact on Taiwan's economy. Taiwan's stock market took a serious blow losing 16% in a little over 6 months. Capital flight out of Taiwan also occurred; \$370M was reportedly withdrawn between March 3 and March 13. The tensions are expected to result in a percentage point cut off GDP growth for 1996.⁹ Furthermore, Taiwan officials announced that the tensions resulted in a sharp drop in the number of new foreign investment contracts.¹⁰ Of greatest significance, Taiwan was forced to use its foreign reserves to avert financial panic, spending an estimated \$20B of its reported \$90.3B in foreign reserves.¹¹

There is considerable economic pressure on both Taiwan and the PRC to maintain peaceful diplomatic relations. One of the PRC's top state economists admitted that the PRC could not afford to attack Taiwan. "It would stop investment in China, stop growth, stop our last

⁶ Laux, David N., President of USA-ROC Economic Council, *Testimony before the House Banking & Financial Services Committee*, March 20, 1996.

⁷ Bangsberg, P.T., "China's Fujian Admits Ill Effects of War Games," *Journal of Commerce*, April 25, 1996.

⁸ Weidenbaum, Murray & Samuel Hughes, *The Bamboo Network: How Expatriate Chinese Entrepreneurs are Creating a New Economic Superpower in Asia*, Martin Kessler Books, 1996, p. 75.

⁹ Harmsen, Peter, "Sooner or Later: Taiwan Pays the Price of Cross-Strait Tensions," *Far Eastern Economic Review*, March 28, 1996, p. 58.

¹⁰ Bangsberg, P.T., "China's Fujian Admits Ill Effects of War Games," *Journal of Commerce*, April 25, 1996.

¹¹ Harmsen, p. 58.

chance to catch up with the rest of the world."¹² Although governments have been hesitant to specify intended actions against the PRC if it were to forcefully reunite Taiwan, indications are that such a move would cause an international outcry, cutting off foreign investment flows and trade relations with the PRC. Such a setback would likely lead to massive unemployment in the PRC's cities and explosive social unrest, threatening Beijing's authority.

By the same token, Taiwan's economic stakes in peaceful relations with the mainland are enormous. Taiwan holds over \$20B in 25,000 investments in the PRC, many of which are managed by way of Hong Kong. When Hong Kong becomes a Special Administrative Region (SAR) of China in 1997, the legal status of Taiwanese officials, investors, and traders in Hong Kong will become ambiguous and may make Taiwan's economic interests vulnerable to PRC interference.¹³ However, the Basic Law of the SAR offers some provision for states that have no formal diplomatic relations with the PRC.¹⁴

In fact, the entire CEA stands to be economically devastated by a lack of peaceful relations. Regional instability would destroy international investor confidence, causing the Taiwan and Hong Kong stock exchange to crash, which would in turn choke off Taiwanese and Hong Kong investment into the PRC.¹⁵

Acknowledging the costs involved with conflict and tension in the Taiwan Strait, the question comes to how much influence these economic costs will have on such political decisions. Despite the economic costs involved, most observers of the Chinese scene share the conviction that the PRC will fight rather than give up what it considers Chinese territory.¹⁶ Whether or not a mutually acceptable arrangement can be made remains to be seen. There is no doubt that 1997 will serve as an indicator to Taiwan, and the world, what Taiwanese unification might involve.

PRC-Hong Kong

The PRC and Hong Kong have enjoyed bilateral economic relations since the PRC's economic reforms in the late 1970's. The two economies have become intimately integrated, feeding off each other to mutually prosper. With reversion just under a year away, the question is what role economic relations will have in facilitating the transition.

Trends and Status of Trade and Investment

The PRC and Hong Kong have developed a complementary relationship. The PRC offers Hong Kong a low-cost, production center. The extent of this relationship is indicated by the fact that Hong Kong manufacturers own or contract with Chinese enterprises, employing six million workers, nearly ten times the number of manufacturing jobs in all of Hong Kong.¹⁷ Hong Kong's remaining manufacturing is in capital-intensive and high-tech industries, offering the PRC advanced technology. Hong Kong, as one of Asia's major financial centers, offers the PRC access

¹² Friedman, Thomas L., "Attacking Taiwan Would Cost China," *New York Times*, March 1, 1996.

¹³ Friedman.

¹⁴ *Taiwan Central News Agency*, "Taiwan Stance to Maintain Hong Kong 'Presence' after 1997," August 26, 1996; and *Hong Kong Ming Pao*, "Consulates will be Dealt with Individually after '97", August 20, 1996.

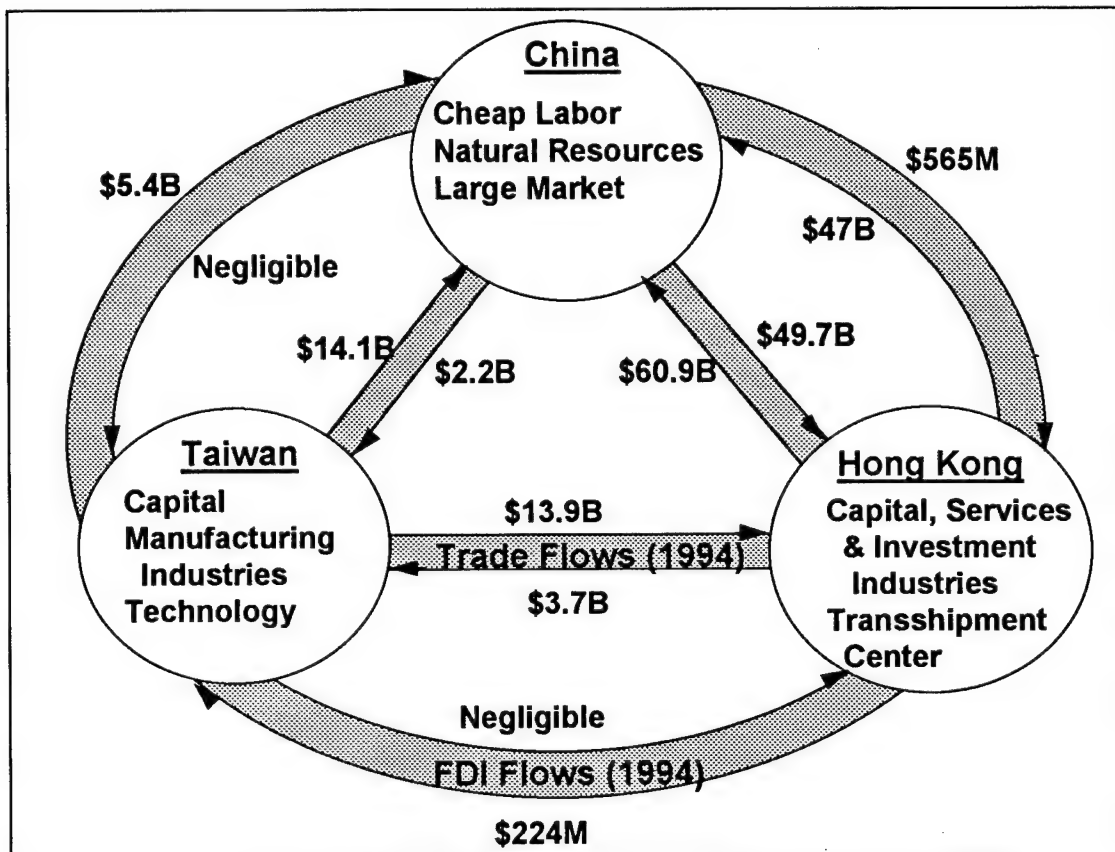
¹⁵ Friedman.

¹⁶ Kissinger, Henry, "The Stakes with China", *The Washington Post*, March 31, 1996.

¹⁷ Weidenbaum & Hughes, p. 65.

to investment markets, as well as transshipment centers. Figure 9-C shows the comparative advantages of the three economies, as well as the official trade and investment flows.

Figure 9-C



Sources: International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1995.
"Who's Whose Biggest Investors," *Far Eastern Economic Review*, October 12, 1995.

The PRC and Hong Kong are each other's largest trading partner. The PRC is Hong Kong's number one export destination, accounting for 33% of Hong Kong's exports; the United States is second, accounting for 23%. Hong Kong serves as the PRC's main transshipment center with an estimated 60% of the PRC's exports going through Hong Kong.¹⁸

Hong Kong is the prime destination for the PRC's outward investment. This investment serves to strengthen the ties between the two economies and enhances Hong Kong's position as the gateway to the PRC. Although precise data is lacking, it appears that the PRC surpassed Japan in 1993 to become the foremost investor in Hong Kong, in terms of cumulative investment. More than 2,000 of the PRC's government agencies and private enterprises have invested about \$25 billion in Hong Kong trade, real estate, transport, and financial enterprises. An indication of the level of financial integration is the fact that the Bank of China is the second largest bank in Hong Kong.

Hong Kong's investment in the PRC has also served to create a strong bond of interdependence. Two-thirds of the foreign investment flowing into the PRC since 1979 has been

¹⁸ Weidenbaum & Hughes, p. 65.

from Hong Kong. By the early 1990s, three out of four Hong Kong companies had operations in the PRC, comprising about 23,000 joint ventures. Five out of six employees of Hong Kong companies work in the PRC.¹⁹

Statistics regarding Hong Kong's investments are uncertain because of investment from third parties through Hong Kong. In the PRC's statistics, investment from Hong Kong is not differentiated from investment from subsidiaries of foreign companies incorporated in Hong Kong. Analysts estimate that as much as one-fourth of the "foreign" investment in the PRC is actually mainland money that is recycled in order to qualify for special import incentives.²⁰

Implications of 1997 Reversion

Under the Joint Declaration of 1984 between the PRC and Great Britain, Hong Kong will become a special administrative region of the PRC on July 1, 1997. Hong Kong and the PRC will have a common defense force, and Beijing will handle defense and foreign relations. The declaration promises Hong Kong a high degree of autonomy and retention of its present social, economic, and legal systems for 50 years. Although the Joint Declaration is very explicit in nature, the enforcement mechanism for these commitments is not yet apparent, leading to much apprehension.

There are several indications that the PRC will not deliberately endanger the economic strength of Hong Kong. The PRC has made several assurances that it will not tap Hong Kong's economic resources. It has agreed not to levy any taxes against the territory. Beijing has also said it has no intention of touching Hong Kong's foreign exchange reserves.²¹

There is still apprehension that the transition will mean high economic losses to Hong Kong. Of particular concern is the possibility that the PRC will void contracts signed prior to 1997 or nationalize certain industries. Evidence of this uncertainty is seen in the fact that over a quarter of Hong Kong's residents will have secured "rights of abode" in other countries by 1997.²² Many others have moved their valuables out of Hong Kong; over half of the colony's top 200 corporations maintain their registration outside of Hong Kong.²³ Clearly, significant portions of Hong Kong's population, companies, and resources are positioned to exit if the reversion significantly interrupts economic development.

Despite the economic incentives for Beijing to honor the Joint Declaration, Beijing has issued statements and made moves implying otherwise, reflecting the complex interplay of political control that is being played out in the PRC. A final complicating factor in the fate of Hong Kong is the regional power struggle between the provinces and Beijing. Hong Kong is well along the path of economic integration with the mainland. However, this integration is limited primarily to Southern China. The fate of Hong Kong is thus caught up in the larger struggle within the PRC between centralization and decentralization and, specifically, between Southern China and Beijing.

¹⁹ Bhala, K. T., "Hong Kong Reborn: Why Asia's Big Test Case Will Succeed", *The Christian Science Monitor*, January 9, 1996.

²⁰ Weidenbaum & Hughes, p. 65.

²¹ Bhala.

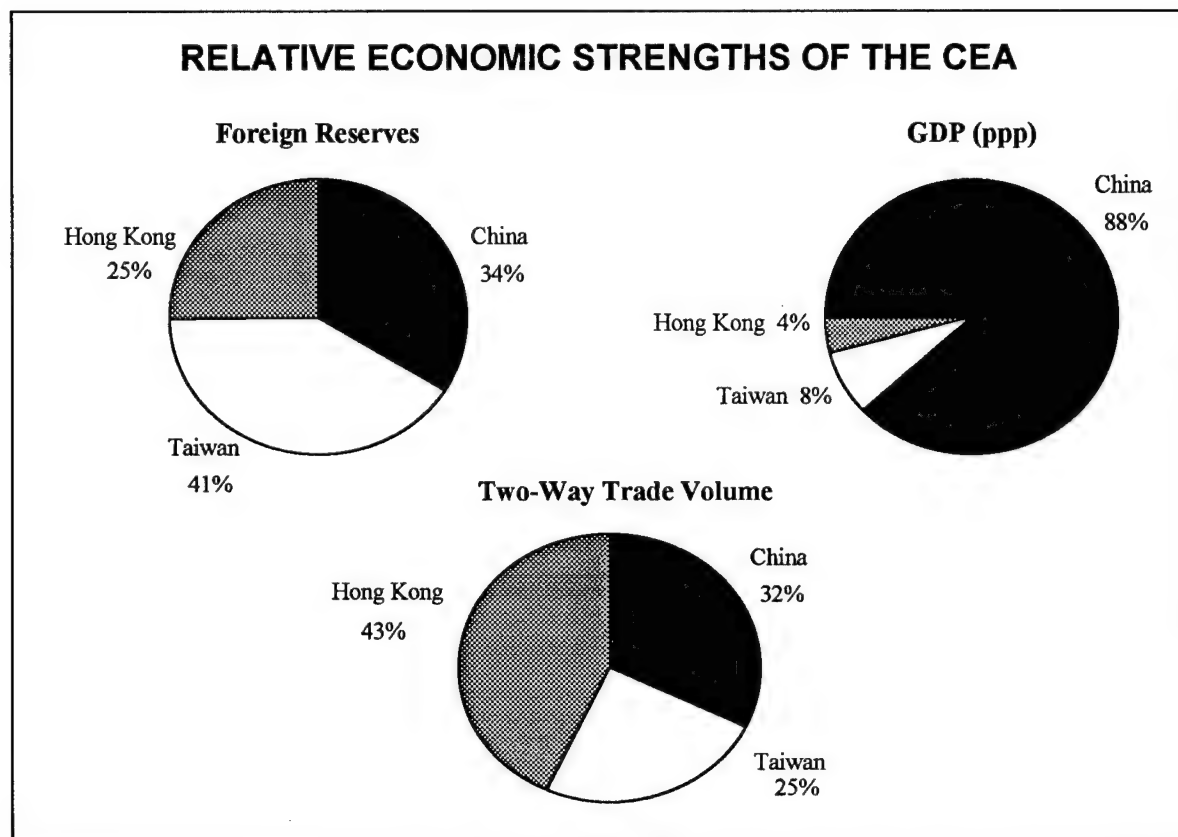
²² Crane, George T., "Greater China: The Ties That Don't Bind," *Current History*, September 1995, pp. 270-274.

²³ Weidenbaum & Hughes, p. 68.

Chinese Economic Area - World

The CEA is a rapidly growing, economic area. Each of its component parts, the PRC, Taiwan, and Hong Kong, represent powerful economic forces. Figure 9-D shows the relative strengths of each of the economies; Taiwan has the largest share of foreign reserves, China the majority of the GDP, and Hong Kong the largest share of international, two-way trade volume.

Figure 9-D



Sources : International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1995; Central Intelligence Agency, *The World Factbook* 1995; The World Bank, *The World Bank Atlas* 1996; and *Far Eastern Economic Review*.

The CEA is an influential economic region in the world economy. The PRC's GDP is estimated at \$2.98 trillion (PPP), surpassing Japan at \$2.53 trillion (PPP), to make it the second largest economy in the world;²⁴ the more common but less representative exchange rate method calculates China be the seventh largest economy. Based on purchasing power parity (PPP), Hong Kong has the highest per capita GDP in Asia and has the world's eighth-largest two-way trade volume.²⁵ Taiwan's GDP is estimated at \$257B (PPP) making it the 20th largest economy in the world. The CEA, as a unit, replaces Mexico as the United States' third largest trading partner, after Canada and Japan.²⁶

²⁴ Central Intelligence Agency, *The World Factbook* 1995. Also supported by *The World Bank Atlas* 1996.

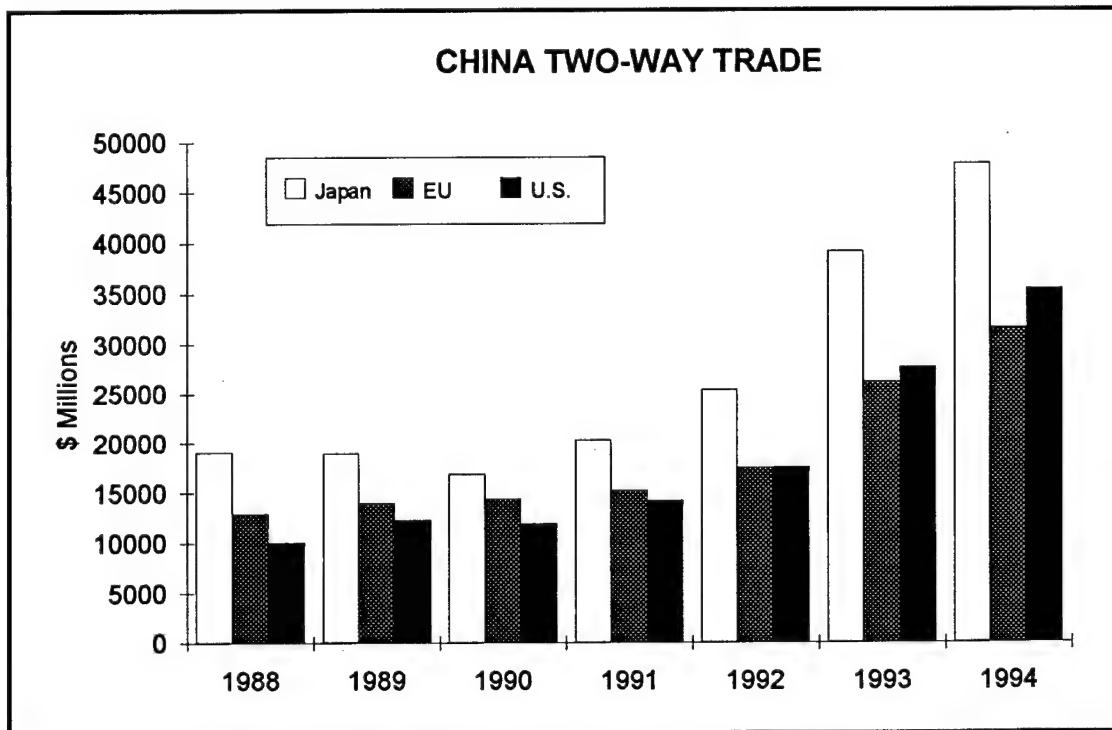
²⁵ Hottelet, Richard C., "The Deal Sealed, Hong Kong Waits and Hopes," *Christian Science Monitor*, March 27, 1996.

²⁶ Laux, David N., President of USA-ROC Economic Council, *Testimony before the House Banking & Financial Services Committee*, March 20, 1996.

Trends and Status of Trade and Investment

Two-way trade between the CEA and the rest of the world has increased rapidly since 1990. There has been nearly an 80% increase in two-way trade from 1990 to 1994, which is considerably higher than the 24% increase in world trade over the same period. (See Figure 9-E.)

Figure 9-E



Source: International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1995.

The CEA has significant foreign reserves, giving it additional international influence in political and military affairs. Foreign reserves can be used to purchase military hardware or to hire lobbyists in key countries to promote economic and strategic interests. Foreign reserves in the CEA were \$221B in December 1995: Taiwan with \$90.3B, the PRC with \$75.4B, and Hong Kong with \$55.4B. The CEA's reserves are 20% greater than Japan's foreign reserves.²⁷

Foreign investment in the PRC has been the key to its rapid growth. Interestingly, of the PRC's total "foreign" investment capital in 1994, 55% came from Chinese Economic Area: 47 % from Hong Kong, and 8% from Taiwan.²⁸ This implies that the CEA itself has been a key to the PRC's economic growth.

The previous sections suggest that the PRC's health largely influences the health of the CEA. The PRC's health, in turn, is largely influenced by economic relations between the PRC and the United States. Sino-U.S. relations have come under considerable strain over several issues including intellectual property rights (IPR) violations, proliferation of weapons of mass destruction, trade barriers, human rights abuses, and Taiwan tensions. The United States has

²⁷ *Far Eastern Economic Review*, April 25, 1996.

²⁸ U.S. Embassy, Beijing, *China Country Commercial Guide*, 1995-1996.

reacted to these issues by threatening removal of Most Favored Nation (MFN) status and imposition of trade sanctions; however, on May 31, 1996, President Clinton extended MFN trade status to China for another year.

Intellectual property rights (IPR) violations have long been a point of contention in Sino-U.S. relations. Of particular concern to U.S. business interests is Chinese export of pirated goods to other third world countries. U.S. losses from IPR violations are estimated at nearly \$2B in 1995 by industry associations, but economists estimate that these losses are more in the range of \$250M to \$500M. A trade war between the United States and China over alleged IPR violations was narrowly averted just hours before the June 17, U.S. deadline to come to a negotiated agreement. If such a trade war had begun, it would have affected not only the United States and the PRC, but the entire CEA. Hong Kong would have been affected by lost transshipments and losses from its operations located in the PRC; the Taiwan Board of Foreign Trade estimated that Taiwan manufacturers operating in the PRC would have lost \$600M annually if the United States had imposed the proposed tariffs.²⁹

Chinese trade barriers are considered a cause of the U.S. growing trade deficit with the PRC. Since 1989, this trade deficit has grown 40% a year, according to U.S. statistics, reaching \$34B in 1995, one-fifth of the total U.S. trade deficit. In absolute terms, the trade deficit with the PRC is second only to the deficit with Japan. In proportional terms, the imbalance is more severe; Japanese exports to the United States are double its U.S. imports, while Chinese exports are triple its U.S. imports. However, caution should be used when examining Sino-U.S. trade statistics, for there is a discrepancy in the way these trade figures are reported. The United States counts imports based on the country of origin and exports based on the first destination. Therefore, products exported from China through Hong Kong are counted as Chinese exports, but the value of these exports includes the value-added in Hong Kong, which is estimated to be about 25%. However, U.S. exports to China via Hong Kong are counted as exports to Hong Kong. Adjusting for these errors roughly reduces the U.S. trade deficit with China to \$20B.³⁰ Another distortion seen in these figures is the movement of production to China from other Asian countries; this, in effect, has acted to shift a portion of other Asian countries' U.S. exports to China, making their U.S. trade surpluses smaller and China's larger.

The United States punitive threats against the PRC over contentious issues come at a significant cost to everyone involved. The World Bank has predicted that revoking MFN would cut the PRC's exports to the United States by 95%. The promised Chinese retaliation would cost the United States \$12B in lost exports to the PRC and a large portion of the \$14B in U.S. exports to Hong Kong. After July 1, 1997, loss of MFN status would likely have even higher associated U.S. costs. The PRC would suffer a humanitarian crisis as millions of workers in coastal export factories lost their jobs. A loss of MFN benefits to the PRC would also severely affect Hong Kong. Authorities estimate that it would cost Hong Kong up to \$28B in lost trade.³¹ It would threaten the jobs of over 85,000 Hong Kong residents, compared with a current unemployment figure of 98,300. It would also reduce Hong Kong's economic growth rate by 2 to 3%, having a significant impact considering that last year Hong Kong grew 4.6%.³²

²⁹ Her, Kelly, "Losses Loom as US Targets Mainland," Republic of China web page, May 24, 1996, (gio.gov.tw/info/fcj96/).

³⁰ Ching, Frank, "U.S.-Japan-PRC Tripartite Relations: Foundation for a Stable Pacific Community?" *1996 Pacific Symposium*, February 13-14, 1996.

³¹ Mastel, Greg, *The Journal of Commerce*, 11/03/95.

³² Silverman, Gary, "Hong Kong Plays it Cool," *Far Eastern Economic Review*, March 28, 1996, p.59.

To temper U.S. economic influence, the PRC has been engaging in a campaign of economic diplomacy, using its economic power to increase its international political clout and decrease its dependence on the United States. Prime Minister Li Peng explicitly warned that he would use the PRC's growing economic power to send more business to non-American companies unless Washington dropped its efforts to force the PRC to change its ways. This resolve was seen in the PRC's recent closing of two major business contracts with European companies over American companies. The PRC's two-way trade with the EU is nearly as large as its trade with the United States. Moving to further increase the PRC's political clout, Jiang Zemin signed a diplomatic agreement with Russia in April, joining the two countries to fight against "hegemonism, power politics."

Assessment and Implications

The developing consensus among economists and China analysts is that the CEA has the potential to become a major economic force in the world.³³ Cooperation among the three economies play an integral part in bringing this expectation to fruition; Taiwan offers the financial, technological, and educational base, Hong Kong offers the financial resources, and the PRC offers a large market, cheap labor pool, and natural resources. Despite the recent and expected friction, the CEA still has unprecedented economic potential.

To reach this potential, the CEA will have to overcome several significant hurdles. The PRC and Taiwan will have to successfully resume stable, peaceful relations. Hong Kong and the PRC will have to make the reversion successful. The PRC will have to weather the transfer of power from Deng Xiaoping to his successor. Most importantly, the CEA will have to make all of these transitions while maintaining positive relationships with the international community.

Clearly, the international community has just as much at stake with the success or failure of the Chinese Economic Area as the CEA itself. The political, military, and economic future of the entire Asia-Pacific region is largely tied to the CEA's future, and especially to the political climate within the PRC. Economic integration between these economies and the international community has served to increase the stakes of political conflict. But as recent evidence has shown, economic integration is no guarantee of political harmony.³⁴

³³ The World Bank projects that by 2002, the CEA will become the world's largest economy, given the recent rates of economic growth. Brown, Lester H., "Nature's Limit," *State of the World 1995*, p.16.

³⁴ Ross, Robert S., "The Politics of Economic Integration among Taiwan, Hong Kong, and Southern China," *Southern China, Hong Kong, and Taiwan: Evolution of a Subregional Economy*, 1995, p.91.

APPENDICES

"APEC is a core element of our overall policy toward the Asia-Pacific. It is building the networks that are to give definition to a new Pacific Community. And it helps to anchor America in the region not only in economic terms but also in security and political terms."

*Ambassador Winston Lord, Assistant Secretary of
State for East Asian and Pacific Affairs,
Speech to the Commonwealth Club,
San Francisco, January 12, 1995*

"ASEAN continues to demonstrate its growing influence as a positive force in the regional security equation and its well-developed patterns of consultation and cooperation offer useful approaches for the broader multilateral security initiatives such as the ASEAN regional forum."

*Dr. Joseph S. Nye, Jr., Assistant Secretary of
Defense for International Security Affairs,
Before the House Committee on International
Relations, Subcommittee on Asia and the Pacific,
June 27, 1995*

APPENDIX A

MULTILATERAL ORGANIZATIONS

The nations of the Asia-Pacific region have pursued cooperative arrangements since the beginning of the post-World War II period. The dynamic growth of the Asian economies and new security concerns brought on by the end of the Cold War have intensified initiatives for multilateral cooperation. This appendix presents a brief overview of multilateral organizations and arrangements pertinent to economic and security cooperation in the Asia-Pacific region.

Multilateral Economic Cooperation

Asia Pacific Economic Cooperation (APEC) Group APEC is an organization of 18 economies on both sides of the Pacific that seeks to sustain economic development through cooperation on trade and other economic issues.¹ The annual APEC ministers meeting has been given high visibility through concomitant "APEC Leaders Meetings," which provide an opportunity for general discussion among leaders of APEC economies. Progress is also being sought through APEC working groups in the areas of finance, trade and investment, human resource development, telecommunications, and energy. Over the last three years, APEC has made significant progress in advancing the agenda for economic cooperation.

- At the November 1994 APEC meeting held in Indonesia, members agreed in the Bogor Declaration to a goal of free and open trade and investment by the year 2020 for developed countries and by 2010 for industrialized countries.
- The 7th annual APEC Ministerial Meeting took place on November 16-17, 1995 in Osaka, Japan. To augment the Bogor Declaration, attendees approved an action agenda calling for member economies to develop voluntary trade liberalization plans.
- Detailed trade liberalization plans are to be presented at the APEC meeting to be held in the Philippines in November 1996.
- As APEC grows, it is anticipated that the APEC Secretariat in Singapore will be given increased responsibilities, especially in the areas of management and analysis.²

APEC members include Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore, Chinese Taipei (Taiwan), Thailand, the United States, and, admitted in 1995, Mexico and Papua New Guinea (PNG). To promote deepening, rather than widening, of cooperative relations, APEC established a moratorium on additional membership until 1997.

¹ APEC, *An Introduction about APEC*, (www.apecsec.org.sg/apecinfo.html).

² Morrison, Charles, "The Future of APEC: Institutional and Structural Issues," in *APEC at the Crossroads*, National Bureau of Asian Research, April 1995.

The World Trade Organization (WTO) and the General Agreement on Tariffs and Trade (GATT)

GATT is a multilateral treaty that sets the rules for international trade and provides a forum for international trade negotiations. The GATT system of rules, which became effective in 1948, has been refined through a series of successive multilateral negotiating rounds. The Uruguay Round was the eighth of the series. When the Uruguay Round agreement was implemented in June 1995, GATT's administrative structures were replaced by the World Trade Organization (WTO).³

Membership in the WTO now stands at 122 nations, with 29 others in an application status. Figure A-1 identifies current Asian-Pacific members of the GATT, as well as those with the status of Applicant and Observer.

Figure A-1
WTO Status of Asian Countries

WTO Members	WTO Applicants	WTO Observers	Non-Status
Australia	Cambodia	Laos	Bhutan
Bangladesh	China	Kiribati	North Korea
Brunei	Taiwan	Solomon Islands	
Burma	Mongolia	Tuvalu	
Fiji	Nepal		
Hong Kong	Seychelles		
India	Tonga		
Indonesia	Vietnam		
Japan			
Macau			
Madagascar			
Malaysia			
Maldives			
Mauritius			
New Zealand			
Pakistan			
Papua New Guinea			
Philippines			
Singapore			
South Korea			
Sri Lanka			
Thailand			

The WTO is guided by three fundamental principles:

- Non-discrimination. The Most Favored Nation (MFN) principle is the cornerstone of the WTO system. Under MFN, a WTO member is obligated to uniformly apply its trade policies to all of its WTO trading partners. The non-discrimination principle multiplies the results of a negotiated tariff reduction or trade concession across all members.

³ WTO, *How the WTO Works*, (www.wto.org/wtoworks_wpf.html).

- Reciprocity. A country accepting tariff concessions is obligated to offer comparable concessions in return.
- Transparency. WTO articles prohibit the use of quotas and other non-tariff restrictions to trade. The objective is to limit use of protectionist instruments to those that have more visible and certain economic effects, such as tariffs.

Disputes among WTO members over existing rules are handled through the WTO secretariat and ad hoc committees headquartered in Geneva, Switzerland. In the past, differences were settled directly between the countries concerned. Now, members use panels of independent experts to examine the disputes and report their conclusions. WTO members decide whether to accept, by consensus, the findings of the panel of trade experts.

- Developing countries, many of whom complained of being sidelined by the more developed countries during the GATT negotiations, may turn out to be the WTO's biggest winners. The already booming export-oriented economies of East Asia will especially benefit from more open access to global markets.
- China hopes to join WTO, and, under U.S. urging, has announced several steps intended to bring its economic and trade systems in line with WTO norms.
- A study by WTO dismisses the idea that world trade is polarizing into inward-oriented, regional "blocs" and concludes that regional integration agreements bolster the objective of global free trade. Implementing the Uruguay Round will dramatically cut tariffs, thereby reducing the scope of preferences that can be exclusively offered to partners within a regional group. Meanwhile, regional agreements are laying the foundation for global agreement in areas such as environmental protection, investment, and competition policy. WTO is also complementing regional liberalization by making progress in intellectual property protection, services, and agricultural policy.⁴

Asian Development Bank (ADB). The ADB, established in 1966, is an official, international organization that promotes economic and social development through development assistance and project loans.⁵ Many countries, including nonregional members, support ADB through multilateral aid contributions.

- Official Development Assistance to the ADB from the world's major donor countries totaled \$1.3B in 1994. Of this amount, \$618M, or 49%, came from Japan.⁶
- Regional ADB members include Afghanistan, Australia, Bangladesh, Bhutan, Burma, Cambodia, China, Cook Islands, Fiji, Hong Kong, India, Indonesia, Japan, Kiribati, South Korea, Laos, Malaysia, Maldives, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, Nepal, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, Solomon Islands, Sri Lanka, Taiwan, Thailand, Tonga, Tuvalu, Vanuatu,

⁴ WTO, *Regionalism and the World Trading System*, April 1995.

⁵ Asian Development Bank, (www.asiandevbank.org).

⁶ OECD Development Assistance Committee, *Development Co-operation 1995*, Table 23, 1996.

Vietnam, and Western Samoa. The Central Asian Republics of Kazakhstan and the Krygyz Republic joined in 1994, while Uzbekistan became a member in 1995.

- Nonregional members include Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

Economic and Social Commission for Asia and the Pacific (ESCAP). The United Nations' ESCAP is a commission established in 1947 to promote economic development by providing analysis, interpretation of events, and technical assistance.⁷

- In April 1996, the ESCAP meeting in Bangkok focused on rural poverty and sustainable development. Discussions also addressed reforms and funding of ESCAP, as well as proposals for establishing a trans-Asian rail network.⁸
- ESCAP's 51 full members include Afghanistan, Armenia, Australia, Azerbaijan, Bangladesh, Bhutan, Brunei, Burma, Cambodia, China, Fiji, France, India, Indonesia, Iran, Japan, Kazakhstan, Kiribati, North Korea, South Korea, Kyrgyzstan, Laos, Malaysia, Maldives, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, Nepal, Netherlands, New Zealand, Pakistan, Palau, Papua New Guinea, Philippines, Russia, Singapore, Solomon Islands, Sri Lanka, Tajikistan, Thailand, Tonga, Turkey (to be approved by the UN), Turkmenistan, Tuvalu, United Kingdom, United States, Uzbekistan, Vanuatu, Vietnam, and Western Samoa.
- Associate ESCAP members are American Samoa, Cook Islands, French Polynesia, Guam, Hong Kong, Macau, New Caledonia, Niue, and Northern Mariana Islands.

Pacific Economic Cooperation Conference (PECC). Founded in 1980, PECC is a non-governmental organization (NGO) established to promote economic cooperation in the Pacific Basin through a flexible, informal, tripartite network in which business leaders, researchers, and officials can interact.⁹

PECC establishes workshops, task forces, fora, and working groups to concentrate on particular policy areas, which currently include agriculture; human resources; minerals and energy; transportation, telecommunications, and tourism; and the *Pacific Economic Outlook* project.¹⁰ PECC's projects promote policy recommendations to interested governments that share the common goal of open regionalism and the liberalization of trade, investment, and technology flows between regional groupings and among individual economies.

The 22 member committees each send a tripartite delegation of business, government, and academic representatives to the PECC General Meeting held approximately every 18 months. Interim policy matters are handled by a Standing Committee, and administrative functions are carried out by a Secretariat based in Singapore.

⁷ www.unicc.org.

⁸ *Bangkok Post*, April 15, 1996.

⁹ PECC, *About PECC* (www.pointpub.com/pecc/index.html).

¹⁰ PECC, *Pacific Economic Outlook for 1996-97*, June 1996.

- PECC members are from Australia, Brunei, Canada, Chile, China, Colombia, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Peru, the Philippines, Russia, Singapore, Chinese Taipei (Taiwan), Thailand, the United States, Vietnam, and the South Pacific Forum.
- Organizations affiliated with PECC are the Pacific Basin Economic Council (PBEC, a regional business organization), Pacific Trade and Development Conference (PACTAD, an organization of regional academics), and APEC (a forum of governmental leaders). Along with the members, these groups also hold seats on the PECC Standing Committee.
- PECC held its Eleventh General Meeting in late September 1995, at Beijing, China, and had a theme of "Trade Liberalization and Development Cooperation." The agenda included discussions of monetary systems and capital formation, investment flows, APEC, power and steel markets, food and agriculture, and telecommunications and the information superhighway.

Pacific Basin Economic Council (PBEC). The PBEC (established in 1967) is an association of business leaders from throughout the Pacific that promotes open trade and investment and encourages competitiveness based on the capabilities of individual companies.¹¹ Its objectives are to advise governments, generate foreign investment, reduce international trade barriers, stimulate new technology, and balance economic development with a clean environment. PBEC meetings and services involve the business community with government and academic leaders, and provide an unofficial forum for policy discussion. PBEC also cooperates with multilateral organizations such as APEC, WTO, and PECC to ensure that private sector viewpoints are represented.

- PBEC's membership includes over 1,100 member companies in Australia, Canada, Chile, China, Colombia, Fiji, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Peru, Philippines, Russia, Taiwan, Thailand, and the United States. Ecuador has applied for membership and Vietnam has indicated that it will apply this year.
- A highly visible event is PBEC's annual International General Meeting (IGM), which brings together leaders in business, academia, and government from more than 25 countries. Recent IGMs were held in Seoul, South Korea (1993), Kuala Lumpur, Malaysia (1994), and New Zealand (1995). At the May, 1996 meeting held in Washington DC, President Clinton announced the renewal of Most Favored Nation status for China. The 1997 IGM is to be held in Manila, Philippines.
- A recent report written by PBEC observed that companies face significant problems in Asian markets over intellectual property.¹² Several companies have pulled out of Asian markets because of weak regimes to protect intellectual property. The report noted that "Both elements -- good laws and strong enforcement -- must operate hand-in-hand." The Uruguay Round agreement on Trade-Related Intellectual Property (TRIPs) serves as a basis for progress, but requires full implementation to achieve benefits for all economies in the region.

¹¹ PBEC, *PBEC Background Information* (www.pbec.org/Info/Background.htm).

¹² PBEC, *Implementing Free Trade and Investment in the Pacific Region*, (www.pbec.org/Papers&Speeches/Policypaper.htm), June 1996.

Pacific Trade and Development Conference (PACTAD). Established in 1968, PACTAD is an NGO that provides a forum for East Asian, Australian, and U.S. economists to discuss trade and development issues. Conference participation is not fixed, but depends on the focus of each conference.

North American Free Trade Agreement (NAFTA). The North American Free Trade Agreement (NAFTA) is an agreement among the United States, Canada, and Mexico that creates a free trade zone in North America. It is the first reciprocal free trade pact between a developing economy and industrialized countries. NAFTA is consistent with General Agreement on Tariff and Trade (GATT) principles. It is not structured as a protectionist bloc and does not increase tariffs or create exclusionary barriers to trade. NAFTA will phase out tariff and non-tariff barriers over a period of 15 years in such sectors as manufactured and agricultural goods, financial and other services, telecommunications, and direct investment. NAFTA also addresses intellectual property rights.

The text of NAFTA was signed in December 1992, by the United States, Canada, and Mexico. To address a number of reservations concerning NAFTA, in December 1993, President Clinton signed a package of side agreements that deal with issues such as the environment, import surges, border clean-up, and worker adjustment assistance. The NAFTA entered into force January 1, 1994.

Association of Southeast Asian Nations (ASEAN)

ASEAN. In 1976, ASEAN was established under the Treaty of Amity and Cooperation in Southeast Asia (the "Bali Treaty").¹³ Original signatories were Thailand, Singapore, Malaysia, Indonesia, and the Philippines. Brunei joined in 1984, and Vietnam became a member in 1995. At the 1996 ASEAN Ministerial Meeting, formal applications for the membership of Cambodia and Laos in 1997 were accepted; Burma was granted observer status.

- In conjunction with an annual meeting of ASEAN ministers, a Post-Ministerial Conference (PMC) is held among ASEAN countries and its dialogue partners. PMCs focus on economic issues. ASEAN's ten dialogue partners are Australia, Canada, the European Union, Japan, New Zealand, South Korea, the United States, and, added in 1996, India, China and Russia. The Senior Officials Meeting (SOM) supports the PMC process by bringing together senior officials of ASEAN and the dialogue partners to discuss such issues as multilateral approaches to security, preventive diplomacy, conflict management, and confidence-building measures.
- Numerous bilateral relations exist between ASEAN and other countries. For example, the U.S.-ASEAN Alliance for Mutual Growth (AMG) is a joint government and private sector initiative established in 1993 to strengthen U.S. trade and investment ties with ASEAN through a variety of cooperative programs in sectors such as autos, aerospace and telecommunications; through coordination of product standards; and through development of human resources.

¹³ ASEAN, *ASEANWEB*, (www.asean.or.id). See "ASEAN Regional Forum (ARF)" under Multilateral Security Cooperation.

East Asia Economic Caucus (EAEC). EAEC was proposed as a possible forum in 1991 by Malaysian Prime Minister Mahathir, with the intention of bringing together some Asia-Pacific nations, including Japan, but excluding the United States, Canada, Australia, and New Zealand. The forum was originally intended as an Asian reaction to the slow progress in GATT, and to perceived protectionism of NAFTA and the European Union. However, the purpose of the proposal has not been clearly defined.

At the 1993 ASEAN meeting, ministers proposed that EAEC be a caucus within the APEC forum, but that the ASEAN ministers should control the EAEC agenda. Japan and China welcomed this formulation, but South Korea and the United States have remained concerned that the implementation of the idea is still unclear.

Regional Trading Agreements

ASEAN Free Trade Agreement (AFTA). In January 1992, the six ASEAN nations agreed to implement AFTA on January 1, 1993, with a goal of reducing tariffs to a maximum of 5.0% over the next fifteen years. As currently structured, AFTA mechanisms are consistent with both GATT and APEC. Tariff reductions apply to selected manufactured products, including capital goods and processed agricultural products. Members are allowed to exclude certain products for industries it considers to be too sensitive to reduced tariffs.¹⁴

- ASEAN has a large domestic market of 410 million people and accounted for a combined Gross National Product (GNP) in 1994 of over \$1.6T, when measured on a purchasing power basis.
- Most ASEAN trade is with external markets; only one-fourth of ASEAN's trade is among its own members. Nevertheless, intra-ASEAN trade is growing faster than total exports, especially in those sectors sharing the Common Effective Preferential Tariff (CEPT).¹⁵ About 41% of products will have 0% tariff rates by the year 2003. AFTA will have longer term effects on investment trends and the development of specialized industrial niches.

South Asian Association for Regional Cooperation (SAARC). SAARC is a regional economic association consisting of Bangladesh, Bhutan, India, Maldives, Pakistan, and Sri Lanka. In 1995 the *South Asian Preferential Trade Arrangement* (SAPTA) was established to promote tariff concessions consistent with GATT. SAPTA and AFTA are the only two regional trading agreements in Asia.

Sub-Regional Economic Zones

In the pursuit of higher economic growth, neighboring countries are discovering the benefits of easing economic relations through cross-border associations called sub-regional economic zones. Many of these zones are an outgrowth of country experiences with export processing zones or UN-sponsored development projects.¹⁶ Examples include: (See Figure A-2.)

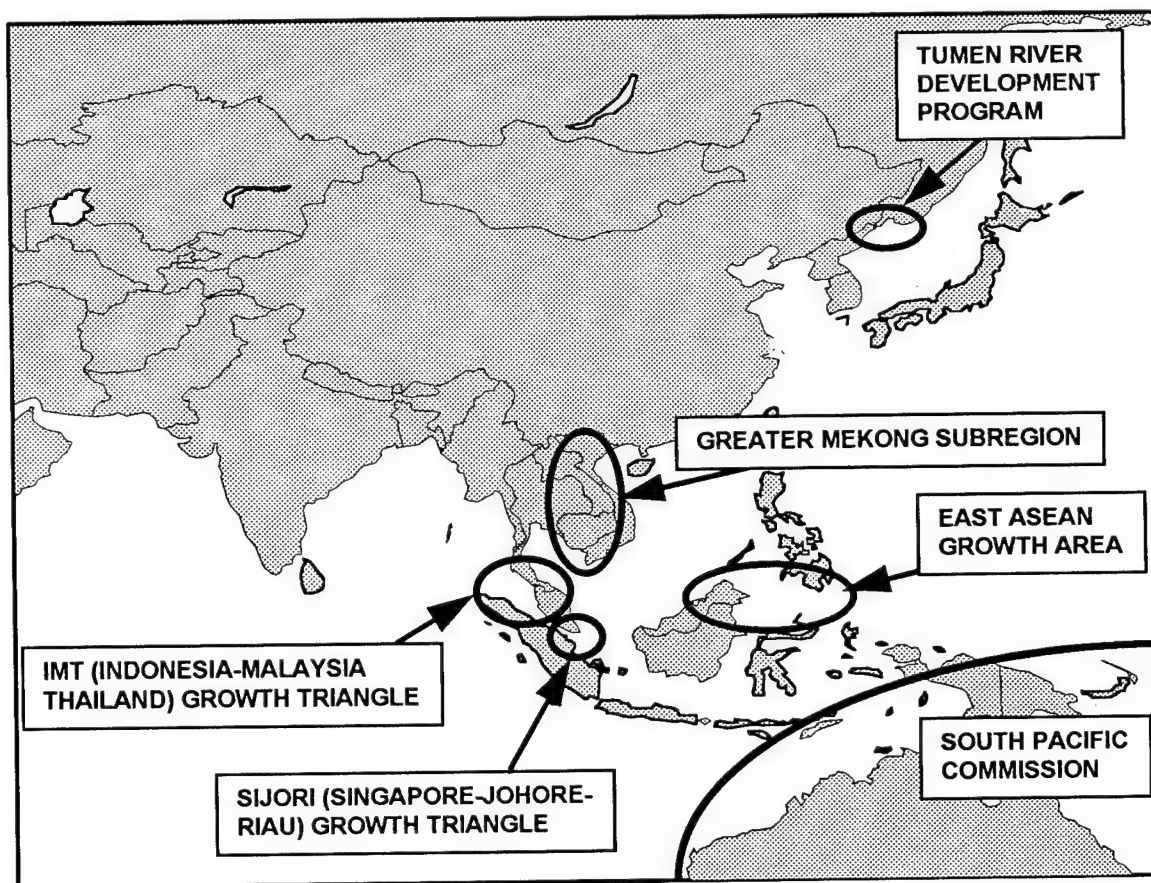
¹⁴ Imada, P., and Naya, S., "Implementing AFTA, 1992-2007," *The ASEAN Reader*, Institute of Southeast Asian Studies, 1992.

¹⁵ Ninth AFTA Council Meeting, *Joint Press Statement*, 26 April 1996, (www.asean-server.asean/economic/afta/eco_ac9.htm).

¹⁶ ADB, *Asian Development Outlook 1996-1997*, 1996; ADB, *Asian Development Outlook 1995-1996*, Box 1.2. 1995; and Far Eastern Economic Review, *Asia 1996 Yearbook*, December 1995.

- The *East ASEAN Growth Area* includes Brunei, Indonesia, Malaysia, and the Philippines.
- The *SIJORI* growth triangle comprises Singapore, the southern part of the Malaysian state of Johor, and the islands of Riau Province of Indonesia.
- The *Indonesia-Malaysia-Thailand Growth Triangle* (IMT-GT) includes two provinces of Indonesia, four states of northern Malaysia, and five southern provinces of Thailand.
- The *Mekong River Commission* covers parts of Cambodia, Laos, Thailand, and Vietnam. The *Greater Mekong Subregional* (GMS) economic cooperation project also includes Burma and China's Yunnan Province.
- The *Tumen River Development Program* is located at the intersection of North Korea, China, and Russia.
- *South Pacific Commission* consists of 27 Pacific island states and Australia.

Figure A-2
Sub-regional Economic Zones



Multilateral Security Cooperation

ASEAN Regional Forum (ARF). In 1993, the ASEAN Ministerial Meeting decided to turn the security component of the PMC into ARF, which is a forum for bringing together official representatives of member countries to discuss regional security issues. ARF's first meeting was in July 1994, in Bangkok. The second meeting took place in Brunei in August 1995. ARF brings members together to share their regional concerns and interests. With ASEAN as host, the ARF can address a wide range of political and security issues and also elaborate on particular ASEAN security concerns, such as expanding ASEAN's Treaty of Amity and Cooperation into a regional code of conduct. ARF discussions have been initiated over issues such as confidence building measures (e.g., arms registry, notification of military exercises), anti-personnel landmines, chemical weapon proliferation, and the Southeast Asia Nuclear Weapons Free Zone. ARF brings together 21 participants, including the seven ASEAN states (Thailand, Singapore, Malaysia, Indonesia, Brunei, the Philippines, and Vietnam), ASEAN's ten dialogue partners (the United States, Canada, Australia, New Zealand, Japan, South Korea, the European Union, India, China and Russia), as well as Burma, Laos, Papua New Guinea, and Cambodia. Countries that have expressed interest in joining ARF include Kazakhstan, Mongolia, North Korea, Pakistan, France and the United Kingdom.¹⁷

Council for Security Cooperation in the Asia Pacific (CSCAP). CSCAP is a non-governmental organization (NGO) established in 1993 to provide a structured process for regional confidence-building and security cooperation by promoting multilateral dialogue, consultation, and cooperation among academicians, security specialists, and government (including military) officials. CSCAP links member committees in fourteen Asia-Pacific nations: Australia, Canada, Indonesia, Japan, Malaysia, Mongolia, New Zealand, North Korea, the Philippines, Russia, Singapore, South Korea, Thailand, and the United States; there are also two associate members, the EU and India. CSCAP pre-dates the ARF and now seeks to provide research support at the unofficial (second track) level to help advance ARF aims.

CSCAP international working groups undertake policy-oriented studies with a view toward formulating policy recommendations for individual governments and official multilateral dialogues, especially the ASEAN Post-Ministerial Conference (PMC) and ASEAN Regional Forum (ARF). CSCAP is open to all countries and territories of the region, and hopes to include institutes from Vietnam and China, as well as scholars from Taiwan.

Northeast Asia Cooperation Dialogue (NEACD). NEACD is a process for discussing security concerns among the United States and Northeast Asia countries, including Japan, South Korea, North Korea, China, and Russia. Sponsored in the United States by the University of California at San Diego, conferences were held in October 1993 (San Diego), May 1994 (Tokyo), April 1995 (Podmoskovie, Russia), January 1996 (Beijing), and September 1996 (Seoul) focusing on confidence building measures and security cooperation. North Korean officials participated in an initial planning session, but have not attended any of the meetings.

¹⁷ *Jane's Defence Weekly*, May 22, 1996.

APPENDIX B

CAUSES AND CONSEQUENCES OF THE U.S. TRADE DEFICIT

Excerpts from *The Annual Report of the Council of Economic Advisors, February 1996*

International trade and competition make a vital contribution to the growth and well-being of the United States, and U.S. firms and workers have proved themselves successful in that competition. Yet despite the rapid growth of U.S. exports and export-related jobs, public commentary often focuses on the overall trade balance, which shows a large and seemingly intractable deficit. Many critics point to the trade deficit as evidence that the United States is not competing successfully and that international trade is detrimental to the health of the economy. Therefore, they argue, the United States should modify its longstanding policy of encouraging open markets and liberal trade.

This focus is unfortunate, because the trade balance is a deceptive indicator of the Nation's economic performance and of the benefit that the United States derives from trade. Trade policy is neither responsible for, nor capable of significantly changing, the overall trade balance. As noted above, trade policy can have a substantial impact on the sectoral and geographic composition of trade, but the aggregate trade balance is determined by larger macroeconomic factors. Persistent external deficits do entail costs, but effective policies to reduce these costs by narrowing the external deficit are beyond the realm of trade policy.

Sources of the U.S. Trade Deficit

The trade balance is simply the difference between the value of goods and services sold by U.S. residents to foreigners and the value of goods and services that U.S. residents buy from foreigners. Most of what the United States produces (89 percent in 1995) is sold to residents of the United States; the rest is exported. And most of what the United States buys (88 percent in 1995) is produced here; the rest is imported. When we compare total production and total expenditure, those goods and services that we purchase from ourselves net out, and the difference is exports minus imports, or the trade balance. A trade deficit thus results when the Nation's expenditure exceeds its production.

Trade is by far the largest source of foreign income and foreign payments, but there are other external income flows: the main ones are interest and other investment earnings, aid grants, and transfers. Adding these other current flows to the trade balance produces the current account balance, which is the net income that the United States receives from the rest of the world. The current account balance thus represents the bottom line on the income statement of the United States. If it is positive, the United States is spending less than its total income and accumulating asset claims on the rest of the world. If it is positive, as it has been in most recent years, our expenditure exceeds our income, and we are borrowing from the rest of the world.

The net borrowing of the Nation can be expressed as the sum of the net borrowing by each of the principal sectors of the economy: government (Federal, State, and local), firms, and households. In other words, the current account deficit (CAD) is equal to the government's budget deficit ($G - T$, or net borrowing by the public sector) plus the difference between private sector investment and private sector saving ($I - S$, or net borrowing by the private sector):

$$\begin{array}{ccccccc}
 (G & - & T) & + & (I & - & S) & = & \text{CAD} \\
 \text{Government} & & & & \text{Private} & & \text{Private} & & \text{Current Account} \\
 \text{Deficit} & & & & \text{Investment} & & \text{Saving} & & \text{Deficit}
 \end{array}$$

The crucial insight of this identity is that the current account deficit is a macroeconomic phenomenon: it reflects an imbalance between national saving and national investment. The fact that the relationship is an identity and always holds true also means that any effective policy to reduce the current account deficit must, in the end narrow the gap between U.S. saving and U.S. investment.

Consequences of the Current Account Deficit

The current account deficits that arose in the 1980s are an indicator neither of the ability of the United States to compete in the world market, nor of the efficacy of U.S. trade policy. U.S. export growth, and more broadly the growth of the U.S. economy, are much more informative measures of our relative economic standing. The current account deficit has not prevented a rapid increase in employment, and the recent increase in the external deficit is primarily the result of rapid economic growth. Furthermore, given the fiscal policy adopted in the early 1980s and the subsequent decline in the U.S. saving rate, the ability to borrow overseas and run a current account deficit has been critical in maintaining domestic investment and growth over the last 15 years. Had the United States been forced to run a balanced current account, interest rates would have been higher, and investment and economic growth lower, than what we experienced.

If this is so, why should one care about the trade and current account deficits? As explained above, the current account deficit is the difference between our expenditure and our income, and represents our net borrowing from the rest of the world. By running a large and persistent current account deficit we have been borrowing against future income, building up liabilities to the rest of the world that will have to be serviced in the future. Estimates show the United States moving from a net creditor position of over \$250 billion in the early 1980s to a net debtor position of over half a trillion dollars by 1994. The positive net international asset position that the United States had built up over 100 years was eliminated in the space of about 6 years during the 1980s.

The debt-servicing requirements of this buildup of external debt are already making their presence felt. Net income on U.S. external assets was over \$30 billion per year in the early 1980s. This inflow declined over the 1980s and eventually turned negative: in 1995 our net overseas payments are likely to be over \$11 billion. Although these numbers are still quite manageable in an economy that produces \$7,000 billion in income each year, the current trend is for an increasing share of U.S. income to be paid out to foreigners, and thus to be unavailable to support U.S. consumption and investment. In a period in which the size of the retirement-aged population will increase sharply, servicing our net foreign debt will be a further drain on the future working population.

The extent to which we rely on foreign borrowing also influences the terms on which we can borrow. Modern portfolio theory emphasizes the importance of relative rates of return in determining asset holdings. To induce foreigners to hold a larger share of their assets as claims on the United States, we may have to offer a higher interest rate. Very rough estimates place the share of U.S. assets in foreign portfolios at about 9 percent, about 2 percentage points higher than in 1982. This does not appear to be unduly large given the low transactions costs, high liquidity, and strong investor protection that characterize U.S. financial markets. In addition, the ratio of U.S. external debt to GDP is still moderate, and well below the ratios of some other industrial countries. But as the stock of foreign claims on the United States increases, U.S. financial markets will inevitably be more sensitive to foreign perceptions and external considerations.

APPENDIX C DATA TABLES

Table 1: Key Indicators
Table 2: Asia-Pacific Merchandise Trade - 1994
Table 3: U.S. Direct Investment in the Asia-Pacific Region
Table 4: U.S. Aid to the Asia-Pacific Region
Table 5: Asia-Pacific Defense Spending
Table 6: Key Arms Imports to the Asia-Pacific Region, 1994-1995

The data tables present detailed information on activity in the Asia-Pacific economies. The data tables are drawn from available, open sources, such as the World Bank (WB), the International Monetary Fund (IMF), the Asian Development Bank (ADB), the U.S. Department of Commerce, the U.S. Arms Control and Disarmament Agency, and the Institute for International Security Studies.

Table 1, **Key Indicators**, depicts the wide diversity among Asian economies with respect to economic size, population, and per capita income. General economic activity is reflected in the key indicators of population, Gross National Product (GNP), growth in Gross Domestic Product (GDP)¹, inflation, and U.S. trade.

- This table compares the relative size of economies using Gross National Product (GNP). World Bank estimates for 1994 are presented using the Purchasing Power Parity (PPP) method and the more traditional computation based on market exchange rates. The PPP method yields substantially higher estimates of GNP for the countries of Developing Asia when compared to GNP computations based on market exchange rates. In general, GNPs for industrialized economies are smaller when computed according to PPP rather than market exchange rates; the opposite is typically the case for developing economies.² For example, using the PPP method, the size of Japan's economy is 40% of that of the United States; using the exchange rate method, Japan's size is about 64%. For the rest of Asia, however, PPP estimates are significantly higher than when using market exchange rates. For example, India's PPP estimate of GNP is \$1.18B, whereas its exchange rate estimate is only \$279B. China's PPP estimate is \$2.99T, and its exchange rate estimate is \$630B.
- Strong growth rates are evident not only in the Four Newly Industrializing Economies (NIEs, South Korea, Taiwan, Hong Kong, and Singapore) and Southeast Asia, but also in

¹ GDP is the total output produced inside a country in a given year, regardless of whose citizens own the factors of production. In contrast, GNP is the total output produced by those factors owned by citizens of the country. For example, Toyotas produced with Japanese-owned capital located in the United States are included in U.S. GDP, but not in U.S. GNP. Conversely, these same Toyotas would be part of Japan's GNP, but not GDP.

² The PPP-based weights consider prices of a bundle of goods and services, including food, clothing, housing, and transportation. These weights incorporate a more realistic valuation of non-traded output (e.g., housing, domestic transportation), which has little effect on market exchange rates. As such, evaluations of non-traded output for developing countries are typically higher under PPP evaluation than under the market-exchange method, thus leading to larger estimates of output. Additional causes of deviation of market exchange rates from their PPP equivalents include speculative bubbles in foreign exchange markets, exchange market intervention by central banks, asymmetric speeds of adjustment in goods and asset markets, and macroeconomic shocks (e.g., oil shocks).

South Asia. Countries where inflation is a serious problem include Burma, Laos, and Mongolia.

DATA SOURCES

Table	Item	Source
1	GNP	World Bank, <i>The World Bank Atlas 1996</i> , except those noted: (a) - CIA, <i>World Factbook 1995</i> , PPP estimate (b) - CIA, <i>World Factbook 1995</i> , exchange rate estimate (c) - Exchange estimate not available, PPP used
	Population	World Bank, <i>The World Bank Atlas 1996</i>
	GDP % Growth	IMF, <i>World Economic Outlook</i> , May 1996; Asian Development Bank, <i>ADB Annual Report 1995</i> and <i>Asian Development Outlook 1996 and 1997</i> (Asian sub-regions)
	Inflation	IMF, <i>World Economic Outlook</i> ; ADB, <i>Asian Development Outlook</i>
	U.S. Trade	Department of Commerce, Electronic Bulletin Board files "EXPCTY.CEN", "IMPCTY.CEN," March 1996. (Merchandise trade figures only, as service data is not provided on a country basis.)
2	Asia-Pacific Merchandise Trade	IMF, <i>Direction of Trade Statistics Yearbook 1995</i>
3	U.S. Direct Investment	U.S. Department of Commerce, <i>Survey of Current Business</i> , and Electronic Bulletin Board file "INT-INV.BEA," July 1996
4	U.S. Aid	USAID, <i>Congressional Presentation Summary Tables</i> (series)
5	Defense Spending	U.S. Arms Control and Disarmament Agency, <i>World Military Expenditures and Arms Transfers 1995</i>
6	Key Arms Imports	International Institute for Security Studies, <i>The Military Balance 1995/96</i>

Table 2, **Asia-Pacific Merchandise Trade**, presents the most recent, comprehensive trade data for Asia-Pacific economies, showing IMF merchandise trade statistics for 1994. The tables include a breakout of each country's trade with the United States, Japan, and Asian Developing Countries, and reveal the multipolar nature of trade in the Asia-Pacific region.

Table 3, **U.S. Direct Investment Position Abroad**, documents the growing presence of U.S. firms across the Asia-Pacific region.

Table 4, **U.S. Aid to the Asia-Pacific Region**, illustrates the declining U.S. foreign aid levels to Asia-Pacific countries. The table also shows the comparatively small portion of U.S. military assistance, which occurs in the form of International Military Education and Training.

Table 5, **Asia-Pacific Defense Spending**, depicts the changes in defense spending for Asia-Pacific countries as well as the average growth over the last decade. The table also presents the defense share of GNP and the number of troops in each country.

Table 6, **Key Arms Imports to the Asia-Pacific Region, 1994-1995**, is provided to illustrate the key suppliers and types of weapons that have recently been imported by Asia-Pacific countries.

Table 1
KEY INDICATORS

Economy	Population 1994 (Mil) WB/CIA	GNP (PPP-basis)		GNP (Exchange Rate-basis)		GDP % Growth 1995 IMF	Consumer Inflation % 1995 IMF	U.S.	U.S.
		Per Capita 1994 (\$) WB/CIA	Total 1994 (\$M) WB/CIA	Per Capita 1994 (\$M) WB/CIA/ADB	Total 1994 (\$M) WB/CIA/ADB			Exports 1995 (\$M) DoC	Imports 1995 (\$M) DoC
ASIAN DEVELOPING	2,959.1	2,445	7,235,626	766	2,265,671	8.4	10.9	115,559	181,901
1 AFGHANISTAN *	18.9					26.2	14	4	5
2 BANGLADESH	117.8	1,350	159,012	230	26,636	4.7	8.9	325	1,257
3 BHUTAN	0.7	700 (a)	1,200	400	272	7.0	8.0	0.5	0.1
4 BRUNEI	0.3	16,000 (a)	4,430	14,240	3,975		..	189	38
5 CHINA, PR	1,190.9	2,510	2,989,204	530	630,202	10.2	14.8	11,748	45,555
6 FIJI	0.8	5,590	4,310	2,320	1,785	2.4	2	32	78
7 FR. POLYNESIA(93)	0.2	7,000 (c)	1,505	7,000	1,505		1.1	82	14
8 GUAM	0.1								
9 HONGKONG	5.8	23,080	134,626	21,650	126,286	5.0	9.0	14,220	10,294
10 INDIA	913.6	1,290	1,178,544	310	278,739	6.2	10.2	3,296	5,736
11 INDONESIA	189.9	3,690	700,757	880	167,632	8.1	9.4	3,356	7,437
12 CAMBODIA	10.0	630 (a,c)	6,400	630	6,400	7.6	7.8	27	5
13 KIRIBATI	0.1	800 (a)	62	730	56	2.5	6.5	2	1
14 KOREA, S	44.6	10,540	469,694	8,220	366,484	9.0	4.5	25,413	24,184
15 LAOS	4.7	850 (a)	4,031	320	1,496	7.1	19.7	2	10
16 MACAU/MACAO	0.4	10,000 (a,c)	4,800	10,000	4,800			30	895
17 MALAYSIA	19.5	8,630	168,268	3,520	68,674	9.6	3.4	8,818	17,484
18 MALDIVES	0.2	1,500 (a)	360	900	221	5.8	7.7	1	12
19 MARSHALL IS.	0.1	1,500 (a)	75	1,680	88	-2.0	3	32	13
20 MICRONESIA, F.S.	0.1	1,500 (a)	160	1,890	202	2.8	4.7	23	13
21 MONGOLIA	2.4	2,020	4,773	340	801	6.3	56.8	14	23
22 BURMA	45.6	930 (a,b)	41,400	235	10,705	7.2	28.9	16	81
23 NAURU	0.0	10,000 (a,c)	100	10,000	100			1	0
24 NEPAL	21.4	1,080	23,069	200	4,174	5.8	7.0	10	96
25 N. CALEDONIA	0.2	6,000 (c)	1,000	6,000	1,000		1.6	22	37
26 PAKISTAN *	126.3	2,210	279,088	440	55,565	5.3	12.3	934	1,197
27 PALAU	0.0	5,000 (c)	82	5,000	82			8	6
28 PNG	4.2	2,430	10,218	1,160	4,857	-4.6	15.9	51	50
29 PHILIPPINES	66.2	2,800	185,326	960	63,311	4.8	8.1	5,294	7,006
30 SAMOA, AM	0.1	2,600 (c)	128	2,600	128				
31 SINGAPORE	2.8	21,430	60,411	23,360	65,842	8.9	1.7	15,318	18,564
32 SOL. IS.	0.4	2,040 (a)	747	800	291	0.2	7.9	3	4
33 SRI LANKA	18.1	3,150	57,094	640	11,634	5.5	7.7	279	1,260
34 THAILAND	58.7	6,870	403,393	2,210	129,864	8.6	5.8	6,402	11,351
35 TONGA	0.1	3,740	367	1,640	160			8	6
36 TUVALU	0.0	800 (a,c)	8	800	8			0	1
37 VANUATU	0.2	2,640	8	1,150	189	2.0	7	1	0
38 VIETNAM	72.5	1,140 (a)	83,500	190	13,775	9.5	13.1	253	199
39 W. SAMOA	0.2	2,000	400	970	163	6.7	-0.3	8	0
40 TAIWAN	21.3	12,070 (a,b)	257,078	10,215	217,569	6.4	3.7	19,295	28,975
INDUSTRIAL CTYS									
41 US	260.5	25,860	6,737,280	25,860	6,737,367	2.0	2.8		
42 CANADA *	29.1	21,320	620,860	19,570	569,949	2.2	1.9	126,024	145,119
43 JAPAN	124.8	21,350	2,664,096	34,630	4,321,136	0.9	-0.1	64,298	123,577
44 AUSTRALIA	17.8	19,000	338,979	17,980	320,705	3.5	2.7	10,795	3,398
45 NEW ZEALAND	3.5	16,780	59,250	13,190	46,578	3.2	2.3	1,693	1,451
OTHER COUNTRIES									
46 RUSSIA *	148.4	5,260	780,405	2,650	392,496	-4.0	190.2	2,826	4,035
47 N. KOREA	23.5	920 (a,c)	21,300	920	21,300			5	0
48 COMOROS	0.5	1,130	548	510	249	2.2	4.8	1	2
49 MADAGASCAR	13.1	670	8,778	230	3,058	3.4	33.0	10	57
50 MAURITIUS	1.1	13,130	14,496	3,180	3,514	4.1	6.1	24	230
51 SEYCHELLES	0.1	6,000 (a)	430	6,210	453	2.5	1.0	7	2
* Not in USPACOM area									
(a) - CIA World Factbook 1995, PPP est.; (b) - ADB Asian Development Outlook, exch. est.									
(c) - Exch. est not available (PPP used)									
SUMMARY									
4 NIE'S	74.5	12,371	921,809	10,417	776,181	7.6	4.8	74,247	82,017
SE ASIA (w/o Singapore)	421.8	3,689	1,556,104	1,079	455,127	7.9	7.4	24,341	43,531
S. ASIA	1,262.5	1,378	1,739,767	307	387,946	5.8	9.8	4,865	9,645
PACIFIC IS.	6.6	2,886	19,169	1,598	10,614	-4.3	14.5	313	234
ASIAN DCs	2,959.1	2,445	7,235,626	766	2,265,671	8.4	10.9	115,559	181,901
ASIA-PACIFIC	3,128.8	3,298	10,319,251	2,229	6,975,390			192,350	310,327
INDIAN OCEAN	15.0	1,637	24,611	498	7,495			42	291
USPACOM	2,999	3,356	10,064,774	2,310	6,927,320			191,453	309,416
WORLD	5,601	5,632	31,548,403	4,663	26,117,116	3.5		583,031	743,505
OTHER:									
ASEAN(7)	409.9	3,918	1,606,085	1,252	513,073			39,631	62,079
MEXICO	91.9	7,050	647,599	4,010	368,679	-6.9	35	46,311	61,705
CHILE	14.0	9,060	127,239	3,560	50,051	8.5	8.2	3,613	1,931
APEC (18)	2,145.9	7,726	16,578,707	6,645	14,259,161			362,841	508,121
EUROPEAN UNION						2.6	3	117,261	121,451
MID. EAST	266.7			1,580	421,386	3.7	33.1	18,334	17,628
W. HEMIS. DEVEL.	470.9			3,340	1,572,806	0.9	37.9	96,320	103,944

Table 2
ASIA-PACIFIC MERCHANDISE TRADE - 1994

Economy (Source: IMF, Direction of Trade Statistic)	(\$ MILLIONS, U.S.)							
	LISTED ECONOMY		UNITED STATES		JAPAN		LISTED ECONOMY	
	EXPORTS TO/FROM THE WORLD	IMPORTS TO/FROM THE WORLD	EXPORTS TO/FROM LISTED ECON.	IMPORTS TO/FROM LISTED ECON.	EXPORTS TO/FROM LISTED ECON.	IMPORTS TO/FROM LISTED ECON.	EXPORTS TO/FROM ASIAN DEV.	IMPORTS TO/FROM ASIAN DEV.
ASIAN DEVELOPING	\$762,263	\$803,462	\$91,832	\$164,196	\$158,396	\$98,036	294564	281125
1 AFGHANISTAN *			6	6				
2 BANGLADESH	2,699	4,900	233	1161	335	91	259	2456
3 BHUTAN								
4 BRUNEI	2,162	3,142	376	47	134	1187	523	1344
5 CHINA,PR	120,822	115,629	9287	41362	18687	27569	48632	38855
6 FIJI	595	770	118	103	46	60	120	143
7 FR. POLYNESIA(93)	123	634	72	15	24	104	2	31
8 GUAM	58	433					6	220
9 HONGKONG	151,393	161,770	11445	10142	25743	2146	69047	99542
10 INDIA	24,150	25,529	2296	5663		2650	4855	3606
11 INDONESIA	37,958	30,589	2811	7020	7674	12883	9612	8154
12 CAMBODIA	227	1,056	7	1	65	9	187	882
13 KIRIBATI	7	99	24	1	7	3	2	12
14 KOREA,S	96,040	102,348	18028	20375	24361	13524	30891	16270
15 LAOS	337	606	6	10	34	31	98	394
16 MACAU/MACAO	1,845	2,102	18	734	114	30	475	1285
17 MALAYSIA	58,748	59,555	6965	14419	12364	8201	25963	19412
18 MALDIVES	48	222	1	13	11	4	19	169
19 MARSHALL IS.								
20 MICRONESIA, F.S.								
21 MONGOLIA	233	288	7	29	25	58	71	57
22 BURMA	859	1,489	11	73	68	76	505	1243
23 NAURU	33	29					4	5
24 NEPAL	348	600	8	129	66	3	21	407
25 N.CALEDONIA	327	772	27	25	27	126	12	71
26 PAKISTAN *	7,332	8,884	719	1085	856	545	1547	2025
27 PALAU								
28 PNG	2388	1605	65	118	179	727	372	374
29 PHILIPPINES	13,433	22,534	3888	6025	5893	2671	3047	6820
30 SAMOA,AM	12	89					2	18
31 SINGAPORE	96,419	102,210	13022	15657	19605	4645	48812	38397
32 SOL.IS	128	146	1	1	17	87	27	50
33 SRI LANKA	3,332	5,066	198	1173	455	189	218	2016
34 THAILAND	41,757	54,324	4861	10799	14700	8181	12150	15004
35 TONGA	22	86	6	6	9	12	2	15
36 TUVALU	1	17						8
37 VANUATU	25	153	1	4	59	7	4	22
38 VIETNAM	4,706	8,607	172	55	644	1350	1312	5515
39 W. SAMOA	4	80	7		18	3	1	15
40 TAIWAN	93,672	86,706	17078	27942	23790	10719	35812	16183
INDUSTRIAL CTYS								
41 US	512,397	689,310	-	-	118693	63067	91832	164196
42 CANADA *	161,269	155,311	114255	131956	5906	8890	6260	11600
43 JAPAN	395,201	274,123	53481	122470	-	-	158396	98036
44 AUSTRALIA	47,440	53,607	9781	3447	8720	13574	18826	12802
45 NEW ZEALAND	11,954	11,934	1508	1545	1539	2065	2981	1839
OTHER COUNTRIES								
46 RUSSIA *	62,640	38,397	2579	3437	1167	3481	5239	2668
47 N. KOREA	1,703	1,407	0	0	171	327	279	622
48 COMOROS	55	114	0	6	2	0	2	6
49 MADAGASCAR	521	599	48	60	35	37	20	91
50 MAURITIUS	1254	1908	24	234	72	6	23	556
51 SEYCHELLES	86	224	6	3	8	1	21	55
SUMMARY	* Not in USPACOM area							
4 NIE'S	437,524	453,034	59,573	74,116	93,499	31,034	184,562	170,392
SE ASIA(w/o Singapor	159,328	180,413	19,086	38,376	41,508	34,513	52,892	57,525
S. ASIA	38,768	46,690	3,472	9,303	1,791	3,558	7,424	11,922
PACIFIC IS.	3,723	4,913	321	273	386	1,129	554	984
ASIAN DCs	762,263	803,462	91,832	164,196	158,396	98,036	294,564	281,125
ASIA-PACIFIC	1,218,561	1,144,533	156,602	291,658	168,826	114,002	475,046	394,424
INDIAN OCEAN	1,964	3,067	79	316	128	48	85	877
USPACOM	1,213,193	1,138,716	155,956	290,883	168,098	113,505	473,584	393,276
WORLD	4,184,600	4,314,900	512,397	689,310	395,201	274,123	747,900	749,800
OTHER:								
ASEAN(7)	255,183	280,961	32,095	54,022	61,014	39,118	101,419	94,646
MEXICO	56,951	75,425	50,840	50,356	4,192	1,340	745	3755
CHILE	11,658	11,319	2,776	2,073	936	2,099	1,810	1,089
APEC (18)	1,911,662	2,011,441	320,467	465,753	293,116	183,488	565,711	553,672
EUROPEAN UNION	1,464,900	1,454,500	102,820	115,046	57,447	35,469	99,700	113,100
MID. EAST	144,534	137,062	18,890	17,392	10,711	27,810	31,028	19,891
W. HEMIS. DEVEL.	184,881	218,914	92,588	91,809	17,573	9,088	10,333	14,079

Table 3
U.S. DIRECT INVESTMENT POSITION ABROAD

	\$ MILLIONS											
Economy	84	85	86	87	88	89	90	91	92	93	94	95
ASIAN DEVELOPING	15119	15330	16577	17010	18528	20558	22942	30338	33,129	39233	47876	57528
1 AFGHANISTAN *												
2 BANGLADESH			10	12	13	6	7					
3 BHUTAN												
4 BRUNEI			-29	-18	-18	17	26	33	42			
5 CHINA, PR	209	311	167	207	307	436	356	431	563	933	1656	1997
6 FIJI				0	0	1	1	1	1			
7 FR. POLYNESIA	2	3	3	4	4	9	21	27	37			
8 GUAM												
9 HONGKONG	3253	3295	3912	4389	5240	5412	5994	6516	8693	10177	13018	13780
10 INDIA	403	386	421	439	436	427	368	410	484	611	783	836
11 INDONESIA	3987	4434	3217	3070	2921	2771	3175	3783	4384	4770	4885	7050
12 CAMBODIA								55	42			
13 KIRIBATI												
14 KOREA, S	731	743	782	1178	1501	2370	2677	2862	2912	3124	4081	5322
15 LAOS												
16 MACAU/MACAO				0	0	13	13	0				
17 MALAYSIA	1175	1141	1021	952	1135	1263	1513	1711	1596	1988	2343	3653
18 MALDIVES												
19 MARSHALL IS.				0	0	2	2	3	4			
20 MICRONESIA, F.S.												
21 MONGOLIA												
22 BURMA				0	0	0	0	0				
23 NAURU												
24 NEPAL												
25 N. CALEDONIA												
26 PAKISTAN *	113	104	109	161	186	177	184	187	245			
27 PALAU						2	3	4	5			
28 PNG	147	140	147	151	193	54	43	-33	-4			
29 PHILIPPINES	1264	1011	1299	1396	1513	1107	1355	1377	1666	1945	2324	2648
30 SAMOA, AM												
31 SINGAPORE	1943	1884	2256	2384	2311	2998	3183	8294	6715	8867	10310	12570
32 SOL. IS.												
33 SRI LANKA	11	11	13	11	13	10	12	7	9			
34 THAILAND	1088	1054	1078	1274	1132	1511	1789	2038	2594	2947	3741	4596
35 TONGA	2	2	2	3	3	2	4	4	4			
36 TUVALU												
37 VANUATU						1	1	1	1			
38 VIETNAM				0	0	0	0	0	0			
39 W. SAMOA			0	0	1	1	1	1	1			
40 TAIWAN	736	747	1078	1372	1621	1968	2214	2626	2827	3128	3878	4391
INDUSTRIAL CTYS												
41 US												
42 CANADA *	46830	47106	50629	57783	62656	63948	69105	68853	68690	69612	74987	81387
43 JAPAN	7920	9246	11472	15684	18009	19911	22511	24938	26591	31184	36677	39198
44 AUSTRALIA	8674	8427	9340	11363	12823	14368	14997	15795	16928	19054	19900	24713
45 NEW ZEALAND	510	565	598	743	833	1062	3099	2916	3314	3090	3622	4530
OTHER COUNTRIES												
46 RUSSIA *			0	0	0	4	6	9				
47 N. KOREA												
48 COMOROS												
49 MADAGASCAR	7	30			13	5	6	4				
50 MAURITIUS	8	3	4	3	4	3	3	3	3			
51 SEYCHELLES												
SUMMARY												
4 NIE'S	6,663	6,669	8,028	9,323	10,673	12,748	14,068	20,298	21,147	25,296	31,287	36,063
SE ASIA(w/o Singap	7,514	7,640	6,586	6,674	6,683	6,669	7,858	8,997	10,324	11,650	13,293	17,947
S. ASIA	527	501	553	623	648	620	571	604	738	611	783	836
PACIFIC IS.	151	145	152	158	201	72	76	8	49	0	0	0
ASIAN DCs	15,119	15,330	16,577	17,010	18,528	20,558	22,942	30,338	33,129	39,233	47,876	57,528
ASIA-PACIFIC	32,223	33,568	37,987	44,800	50,193	55,899	63,549	73,987	79,962	92,561	108,075	125,968
INDIAN OCEAN	15	33	4	3	17	8	9	7	3	0	0	0
USPACOM	32,125	33,497	37,882	44,642	50,024	55,730	63,374	73,807	79,720	92,561	108,075	125,968
WORLD	212,994	229,748	259,562	307,983	326,900	373,436	424,086	450,196	502,063	559,733	621,044	711,621
OTHER:												
ASEAN(7)	9,457	9,524	8,842	9,058	8,994	9,667	11,041	17,236	16,997	20,517	23,603	30,517
MEXICO	4,568	5,070	4,750	4,997	5,694	7,079	9,398	11,570	13,730	15,229	15,714	14,037
CHILE	46	85	224	224	691	1,018	1,368	1,555	2,544	2,847	4,384	5,510
APEC (18)	83,081	85,259	91,941	107,149	118,562	127,293	142,803	155,265	163,785	178,895	201,520	225,382
EUROPEAN UNION	69,688	81,337	98,472	120,066	126,502	149,975	177,642	188,710	210,164	235,402	251,149	
MID. EAST	5,032	4,811	4,590	4,589	4,589	3,806	3,973	4,715	5,759	6,573	6,794	7,982
W. HEMIS. DEVEL.	25,229	27,901	34,790	44,905	49,283	51,041	71,593	77,342	91,307	101,601	112,226	122,765

(Source: Dept. of Commerce,
Survey Current Business and
EBB file "INT-INV.BEA")

Table 4
U.S. AID TO ASIA-PACIFIC REGION

Economy	TOTAL U.S. ASSISTANCE (\$K)					IMET PORTION (\$K)**	
	1992	1993	1994	1995 Act	Ob 1996 Est Ob	95 Act Obl	96 Est-Obl
1 AFGHANISTAN *	81,200	35,750	1,995	12,390	15,200		
2 BANGLADESH	142,362	124,514	125,073	92,829	75,550	209	250
3 BHUTAN	878	430		194			
4 BRUNEI							
5 CHINA,PR		581	429	624	780		
6 FIJI	1,859	1,727	1,910	1,606	1,492		
7 FR. POLYNESIA							
8 GUAM							
9 HONGKONG							
10 INDIA	187,138	180,921	154,327	161,879	157,718	208	350
11 INDONESIA	54,025	54,918	22,917	58,816	55,200		600
12 CAMBODIA	24,516	27,000	29,597	42,388	26,350	273	350
13 KIRIBATI	437	433	489	472	492		
14 KOREA,S	800	270	21	10	10	10	10
15 LAOS	3,180	2,050	2,000	2,200	2,000		
16 MACAU							
17 MALAYSIA			318	504	600	504	600
18 MALDIVES	95	70		50	80	50	80
19 MARSHALL IS.	530	619	667				
20 MICRONESIA, F.S.	1,651	1,676	1,885	2,193	1,839		
21 MONGOLIA	15,752	11,345	7,922	12,332	5,090	98	100
22 BURMA		1,000		100			
23 NAURU							
24 NEPAL	19,198	17,890	19,218	17,046	26,185	96	125
25 N.CALEDONIA							
26 PAKISTAN *	3,584	4,200	9,608	17,121	2,650		150
27 PALAU							
28 PNG	1,681	2,031	1,902	1,660	1,818	125	170
29 PHILIPPINES	252,936	137,569	62,817	52,871	61,044	1,193	1,200
30 SAMOA,AM							
31 SINGAPORE	15	20	10	20	20	20	20
32 SOL.IS.	967	903	1,082	1,327	1,228	101	100
33 SRI LANKA	65,996	56,599	38,636	13,211	12,434	96	175
34 THAILAND	8,131	15,293	12,753	5,876	4,863	999	1,400
35 TONGA	745	796	1,037	1,009	1,046	50	100
36 TUVALU	47	51					
37 VANUATU	162	324	538	50	769	50	100
38 VIETNAM			688				
39 W. SAMOA	944	996	1,278	48	1,162	48	100
40 TAIWAN							
41 COOK ISL.	104	128					
* Not in Pacific Command Area							
CANADA *							
JAPAN							
AUSTRALIA							
NEW ZEALAND							
OTHERS IN AREA:							
N. KOREA							
COMOROS	2,721	772	777	1,424	155		75
MADAGASCAR	42,644	41,353	32,380	29,275	24,840		100
MAURITIUS	443	75		64	25		
SEYCHELLES	3,723	1,756	414	373	60	10	60
OTHER ASIAN AID:							
ASEAN	3,644	2,450	2,678	1,955			
S.PACIFIC	18,366	21,670	14,000	14,000	14,000		
ASIA REGIONAL	31,325	50,795	34,717	32,176	19,197		
S.E. ASIA CONTINGENCY	3,855	28,500	7,040	4,250			
ASIA BILATERAL TOTAL	926,123	783,519	591,123	582,343	513,897	4,140	6,215
U.S. BILATERAL AID, BY REGION							
AFRICA	1,464,206	1,330,619	1,380,944	1,292,781	1,163,971	4,955	6,500
ASIA	926,123	783,519	557,552	582,343	513,897	4,140	6,215
NEAR EAST + N.AFRICA	5,398,875	5,399,952	5,029,617	5,386,366	5,543,417	4,191	4,265
EUROPE	1,163,916	767,933	770,233	684,975	778,439	7,897	12,865
NIS	132,077	503,833	1,387,620	731,467	961,116	(see Eur)	(see Eur)
LAT. AMER./CAR.	1,365,877	1,328,373	806,004	748,110	651,819	4,883	8,825
OTHER BILATERAL	1,729,435	1,430,446	605,222	2,044,973	1,135,607	284	330
TOTAL U.S. BILATERAL AID	12,180,509	11,544,675	10,537,192	11,471,015	10,748,266	26,350	39,000
TOTAL U.S.-MULTILATERAL ORGS	1,796,835	1,803,419	1,737,488	2,065,000	1,438,264		
MILITARY PORTION	3,397,182		2,316,382	2,524,685	2,571,790	** IMET - Int'l Military	
TOTAL ECON & MIL ASSIST.	13,351,258	13,348,094	12,274,680	12,837,015	12,186,530	Education and Training	

Source: USAID, Congressional Presentation
Summary Tables (series)

Table 5
ASIA-PACIFIC DEFENSE SPENDING

Economy	1994 Dollars (\$M)										Avg Ann Growth	1994 %DEF/GNP	Armed Forces (K)
	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994		
ASIAN DEVELOPING	90,920	93,610	94,224	92,164	95,148	96,105	97,906	95,585	99,046	105,140	106,366	1.4%	8,391
1 AFGHANISTAN *	329	329	329	329	329	329	445	445	445	445	445	4.2%	45
2 BANGLADESH	323	309	315	355	333	325	336	309	341	418	448	2.6%	113
3 BHUTAN													
4 BRUNEI	275	325	542	387	501	413	339	339	416	416	309	0.1%	4
5 CHINA, PR	53220	53230	52010	52460	53110	52370	52610	49470	51210	52680	52840	-0.2%	2930
6 FIJI	20	18	17	30	32	38	38	37	34	28	34	6.7%	4
7 FR. POLYNESIA													
8 GUAM													
9 HONGKONG													
10 INDIA	6395	6582	6984	7326	7560	7548	7285	6749	6657	7583	8233	1.4%	1305
11 INDONESIA	2114	2055	2173	1847	1734	1775	1856	1957	2007	2086	2318	0.4%	280
12 CAMBODIA								69	102	75	61	0.0%	70
13 KIRIBATI													
14 KOREA, S	7904	8224	8671	8716	9331	10240	11340	10930	11620	11920	13030	5.1%	750
15 LAOS	76	73	73	73	73	73	73	73	115	112	114	4.7%	45
16 MACAU/MACAO													
17 MALAYSIA	1323	1285	1466	1656	1052	1255	1344	1851	1820	1974	2121	4.8%	115
18 MALDIVES													
19 MARSHALL IS.													
20 MICRONESIA, F.S.													
21 MONGOLIA	58	59	67	71	80	74	70	35	21	20	17	-13.1%	21
22 BURMA	1533	1626	1562	1520	1314	1598	1699	2114	2024	2730	2618	6.0%	370
23 NAURU													
24 NEPAL	28	28	30	31	30	31	34	32	34	42	43	4.0%	35
25 N. CALEDONIA													
26 PAKISTAN *	1912	2173	2365	2806	2831	2720	3077	2802	3043	3233	3068	4.5%	540
27 PALAU													
28 PNG	50	48	51	49	48	56	77	55	61	56	54	2.1%	4
29 PHILIPPINES	622	635	939	946	1154	1297	1297	1246	1168	1351	1272	7.5%	109
30 SAMOA, AM													
31 SINGAPORE	1820	2082	1950	1988	2258	2334	2180	2667	2894	2960	3064	5.4%	56
32 SOL. IS.													
33 SRI LANKA	117	226	201	257	397	381	449	474	385	535	525	13.8%	23
34 THAILAND	2331	2637	2490	2397	2346	2381	2533	2789	3149	3699	3777	4.5%	290
35 TONGA													
36 TUVALU													
37 VANUATU													
38 VIETNAM (Est.)	3129	3129	3129	1967	2548	1385	804	772	660	547	435	-20.0%	857
39 W. SAMOA													
40 TAIWAN	7341	8537	8860	6953	8087	9482	10020	10370	10840	12230	11540	5.0%	425
INDUSTRIAL CTYS													
41 US	328100	344800	365300	363200	355700	353100	340700	300400	318200	303800	288100	-1.8%	1715
42 CANADA *	8975	9697	10060	10260	10320	10250	10430	9676	9750	9773	9525	0.1%	75
43 JAPAN	32370	34020	35670	37580	39310	40910	42510	43960	44840	45400	45820	3.7%	233
44 AUSTRALIA	6230	3557	6483	6911	6239	6162	6505	7167	7335	8090	8270	4.8%	59
45 NEW ZEALAND	841	828	883	879	930	912	883	601	687	728	613	-3.3%	10
OTHER COUNTRIES													
46 RUSSIA *									145200	113800	96800	12.4%	1395
47 N. KOREA	7003	7024	7074	7108	7088	6968	6611	4995	5735	5409	5500	-3.3%	1200
48 COMOROS													
49 MADAGASCAR	49	46	46	45	38	36	33	31	29	30	24	-6.6%	21
50 MAURITIUS	5	4	4	4	5	6	9	11	11	11	11	13.2%	1
51 SEYCHELLES													
SUMMARY:													
4 NIE'S	17,065	18,843	19,481	17,657	19,676	22,056	23,540	23,967	25,354	27,110	27,634	5.1%	1,231
SE ASIA (w/o Singapore)	9,870	10,139	10,812	9,273	9,408	8,579	8,246	9,096	9,437	10,260	10,407	-0.2%	1,770
S. ASIA	10,637	11,273	11,786	12,624	12,794	12,932	13,325	12,925	12,929	14,986	15,380	3.1%	2,431
PACIFIC IS.	70	66	68	79	80	94	115	92	95	84	88	3.5%	8
ASIAN DCs	90,920	93,610	94,224	92,164	95,148	96,105	97,906	95,585	99,046	105,140	106,366	1.4%	8,391
ASIA-PACIFIC	137,364	139,039	144,334	144,642	148,715	151,057	154,415	152,308	157,643	164,767	166,569	1.9%	9,893
INDIAN OCEAN	54	50	50	49	43	42	42	40	40	41	35	-3.5%	22
USPACOM	135,177	136,587	141,690	141,556	145,598	148,050	150,935	149,103	154,195	161,130	163,091	1.8%	9,330
WORLD	1,241,800	1,271,600	1,297,000	1,297,700	1,284,800	1,241,300	1,203,300	1,101,100	971,400	884,900	840,300	-4.2%	840,300
OTHERS:													
ASEAN(7)	11,614	12,148	12,689	11,188	11,593	10,840	10,353	11,621	12,114	13,033	13,296	0.7%	1711.0
MEXICO	1,919	2,003	2,031	2,252	1,776	1,813	1,510	1,490	1,727	1,638	2,246	-1.3%	2,246.0
CHILE	1,008	1,004	919	1,203	1,149	1,061	119	1,218	1,088	1,063	966	-1.6%	966.0
APEC (18)	456,443	474,967	500,498	499,684	495,045	495,811	486,253	446,186	468,812	459,864	445,865	-0.6%	10,267.0
MID. EAST	99,400	92,400	86,600	77,900	72,700	66,100	90,400	97,200	84,800	53,400	45,100	-4.9%	45,100.0
LATIN AMER.	24,900	22,600	24,800	23,300	22,700	22,600	22,200	19,900	19,000	19,100	19,300	-2.8%	19,300.0
WESTERN EUR.	200,000	202,300	202,200	205,300	201,600	203,000	204,100	207,000	197,000	190,400	186,400	-0.6%	186,400.0

* Not in Pacific Command Area of Responsibility

Table 6
KEY ARMS IMPORTS OF THE ASIA-PACIFIC REGION, 1994-1995

Country	Supplier	Weapon System	Quantity
China	Uzbekistan	Ilyushin 76M transport aircraft	15
Japan	U.S.	Boeing 767-200 AWACS aircraft (ordered)	4
South Korea	U.S.	AH-1 Cobra helicopters	10
	Germany	T-209/1200 class submarines	1
	U.S.	P-3C Anti-submarine warfare aircraft	8
	U.S.	F-16 aircraft (initial delivery of order for 120)	12
Taiwan	U.S.	M-60 tanks	20
	U.S.	AH-1 Cobra helicopters	24
	U.S.	OH-58D Kiowa helicopters	12
	U.S.	Knox-class frigates (leased)	2
	U.S.	Aggressive-class minesweepers	4
	U.S.	E-2C Hawkeye early warning aircraft	4
	U.S.	E-2D Hawkeye early warning aircraft (ordered)	4
Thailand	China	Naresuan-class frigate (1 of 2 ordered)	1
	U.S.	Knox-class frigate (leased)	1
	U.S.	P-3A Orion maritime aircraft	2
	U.S.	A-7E Corsair maritime attack aircraft	14
Cambodia	Czech Republic	T-55 tanks	40
Vietnam	Russia	Su-27 air-defense fighters	6
Fiji	Australia	Kulu-class patrol craft	2
Malaysia	South Korea	Korean Infantry fighting vehicle (KIFV)	69
	U.S.	LST511 tank landing ship	1
	U.S.	Newport-class tank landing ship (leased)	1
	UK	UK-built frigates	2
	UK	Hawk 208 ground attack aircraft	12
	Russia	MiG-29 advanced fighters	18
Indonesia	Indonesia	CN-235 transport aircraft (ordered)	6
	UK	Scorpion light tanks	26
	UK	Hawk 100/200 series aircraft (ordered)	24
	Malaysia	MD3-160 series trainer aircraft (ordered)	20
Burma	China	Type-85 armored personnel carriers	150
	China	F-7, A-5 aircraft (ordered)	30
	China	Y-8 transport aircraft (ordered)	2
	China	Hainan-class coastal patrol boats (ordered)	6
	China	Armored fighting vehicles (ordered)	60
	China	Artillery pieces (ordered)	50
India	Germany	Do-228 maritime patrol aircraft	10
	Russia	MiG-27 fighter ground attack aircraft	28
		MiG-29 advanced fighters (ordered)	10
Pakistan	China	M-11 missiles/components	30?
	China	Type-85 tanks	100
	UK	Amazon-class frigates	2
Bangladesh	UK	River-class mine-sweepers	4
	China	Minesweeper	1

Source: International Institute for Security Studies, *The Military Balance 1995/96*, October 1995

APPENDIX D

GLOSSARY

ACDA	Arms Control and Disarmament Agency
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Agreement (or Area)
AMG	Alliance for Mutual Growth
AOR	Area of Responsibility
APEC	Asia Pacific Economic Cooperation
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
BEM	Big Emerging Market
BTU	British Thermal Units
C ³	Command, control, and communications
CEA	Chinese Economic Area (PRC, Hong Kong, Taiwan)
CIA	Central Intelligence Agency
CINC	Commander in Chief
CSCAP	Council for Security Cooperation in the Asia Pacific
EAEC	East Asian Economic Caucus
EEZ	Exclusive Economic Zone
EIA	Energy Information Administration
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union (formerly European Community)
EW	Electronic Warfare
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GMS	Greater Mekong Subregional economic cooperation project
GNP	Gross National Product
IGM	International General Meeting
IISS	International Institute for Strategic Studies
IMB	International Maritime Bureau
IMET	International Military Education and Training
IMF	International Monetary Fund
IMO	International Maritime Organization
IMT-GT	Indonesia-Malaysia-Thailand Growth Triangle
MFN	Most Favored Nation
MMBD	Million Barrels per Day
MMT	Million Metric Tons
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NDU	National Defense University
NEACD	Northeast Asia Cooperation Dialogue
NGO	Non-governmental Organization
NIE	Newly Industrializing Economy

NIS	Newly Independent States
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OTA	Office of Technology Assessment, U.S. Congress
PACTAD	Pacific Trade and Development Conference
PBEC	Pacific Basin Economic Council
PECC	Pacific Economic Cooperation Conference
PMC	ASEAN Post-Ministerial Conference
PNG	Papua New Guinea
PPP	Purchasing Power Parity
PRC	Peoples Republic of China
ROK	Republic of Korea
SAARC	South Asian Association for Regional Cooperation
SAPTA	South Asian Preferential Trade Arrangement
SCS	South China Sea
SIJORI	Singapore-Johor-Riau growth triangle
SIPRI	Stockholm International Peace Research Institute
SOM	Senior Officials Meeting
SPC	South Pacific Commission
TEU	Twenty-foot Equivalent Units (shipping)
USAID	Agency for International Development
USCINCPAC	Commander in Chief, U.S. Pacific Command
USTR	U.S. Trade Representative
WTO	World Trade Organization